COMMERCIAL LETTERS OF CREDIT

THE commercial letter of credit has a long mercantile history. It has a much shorter legal history. But it is no new thing in English and American law. And yet, after an experience of over a century, the law upon this important subject is confused and uncertain.

Although merchants and bankers have been using commercial letters of credit for decades and from long experience, more or less uniform, understand in a business way the business obligations which are created as a result of their issue, it is nevertheless uncertain in what manner or at what moment of time the law predicates upon them legal rights and obligations. Do rights and obligations arise at the moment the letter is issued as the result of a contract which is formed at that time, or do obligations and rights arise at some subsequent time? If they arise at a subsequent time, is it because the letter is an offer which, when accepted, becomes a contract, or is it because the letter amounts to a representation which, when acted upon, creates some legal right by estoppel? Upon the answer to these questions depends the solution of the important problems of the effect of revocation, fraud, mistake, failure of consideration, insolvency, and assignment. Some of these problems have never been presented for solution; others have been dealt with in an uncertain and unsatisfactory manner.

This situation is undesirable both from a mercantile and from a legal point of view. Commercial letters of credit are in constant use; they involve large amounts; their nature and effect are well understood in the business world. Certainty in law is therefore a matter of importance. But no banker or merchant can rely upon the law as it is at the present time, and no lawyer can safely advise clients.

This confusion in legal analysis is referable to a large extent, if not solely, to an imperfect understanding of the business transaction and to an attempt to fit all letters of credit into one

category both factual and legal. No correct legal analysis can be made unless there is first made a correct business analysis. The law is seeking to give effect to the expressed will of the parties, and not to force the parties into a preconceived legal notion of what their will ought to be. The actual business transaction in the particular case is consequently the essential basis of the legal result. If the business transaction may assume a variety of forms, each differing materially in its facts and in the relation of the parties, the legal analysis is necessarily affected.

The business transaction which gives rise to commercial letters of credit will, therefore, merit an extensive examination before the legal transaction can be discussed.

I

THE BUSINESS TRANSACTION[1]

When a prospective buyer in one locality desires to purchase goods of a prospective seller in another locality there arises the problem of financing the sale. If the seller is to manufacture the goods, or to procure the merchandise from some third person, he wishes to be certain that the buyer will take and pay for them when they come into existence, or are procured, and put on board the ship or cars. If the seller already has the goods, he desires to be paid the purchase price upon shipment. The buyer, on the other hand, wishes to be certain that the goods have been shipped according to instructions and he does not desire to pay before they have been

[1] There is no complete account of the business transaction to be found in any one book. The best description of the use of commercial letters of credit will be found in Whitaker, Foreign Exchange (N. Y., 1919). Other useful books are: Escher, Foreign Exchange Explained (N. Y., 1920); Preciado, Exporting to the World (N. Y., 1920); Silver, Commercial Banking and Credits (N. Y., 1920); United States Department of Commerce, Paper Work in Export Trade (Wash., 1920); York, Foreign Exchange, Theory and Practice (N. Y., 1920); Savay, Principles of Foreign Trade (N. Y., 1919); Wolfe, Theory and Practice of International Commerce (N. Y., 1919); Brown, Principles of Commerce (N. Y., 1918); Dudeney, The Exporter's Handbook (London, 1916); Escher, Elements of Foreign Exchange (N. Y., 1915); Hough, Practical Exporting (N. Y., 1915); Spalding, Foreign Exchange and Foreign Bills (London, 1915); United States Department of Commerce and Labor, Foreign Credits (Wash., 1912); Modern Business, Vol. 6 (N. Y., 1910); Brooks, Foreign Exchange Text Book (Chicago, 1908); Margraff, International Exchange (Chicago, 1903). See also special pamphlets published by New York banks.

received and marketed. Payment may be made, according to the terms of the sales contract, in one of five ways: (1) cash with the order or against shipping documents; (2) the buyer's promissory note, or the note of a third person, or bills of exchange on a person other than the buyer, properly accepted and indorsed, sent with the order, or surrendered against shipping documents; (3) open, or book, credit with subsequent remittance in cash or commercial paper; (4) trade acceptance, or bills of exchange drawn by the seller on the buyer; (5) letter of credit.

None of the first four methods is satisfactory both to the buyer and to the seller. To compel the buyer to send cash with the order or to pay cash against shipping documents would often put an impossible burden upon his capital. His desire to postpone actual payment is met when he sends his own note. The seller, however, will often refuse to do business on such terms, for in a place where the maker is not known the paper is not marketable. The seller must at all events trust the credit of the buyer. When the note, or the accepted draft, of a third person, usually a bank, is given, the seller has commercial paper of greater marketability, but, on the other hand, the buyer has had to pay the bank cash for the paper or has had to give security, and it is important to note that the goods which form the subject matter of the sales contract cannot conveniently be used for this purpose. Moreover, from the buyer's point of view, there is a further disadvantage: he is anxious to turn over notes or drafts against shipping documents, and in order to accomplish this result he must forward the negotiable instruments to some agent in the seller's town or country with proper instructions to the seller and to the agent. The open credit places upon the seller the entire burden of the buyer's honesty and solvency. The trade acceptance is also open to objections by the seller. If the draft is a clean bill of exchange, not only is it not readily marketable but the chances of secondary liability of the seller as drawer are considerable. If a purchaser for the bill is obtained, it is usually because he relies entirely on the financial standing of the drawer. Many banks refuse to discount this kind of paper, not simply because they are unwilling to trust the unsecured credit of the drawer, but because they do not care to purchase paper which is likely to be protested. If the draft is a documentary bill of exchange, a purchaser is more easily obtained, for he now has the security of

the goods in addition to the secondary liability of the drawer. Nevertheless, he prefers to rely on neither of these. He dislikes handling the goods or proceeding against parties secondarily liable. He is concerned chiefly with having the draft accepted and paid, and of acceptance and payment he is in doubt. Hence, very often the seller is forced to deposit for collection.

The business problem is how to meet the desires of both the buyer and the seller; how to enable the seller to receive his money upon shipment; how to enable the buyer to postpone actual payment until the goods have been received and resold; how to enable a bank to lend its credit and not its funds; how to utilize the goods as security in the meantime. The instrumentality of the commercial letter of credit meets these requirements perfectly.

DEFINITION OF TERMS

To attempt to define a commercial letter of credit would be more than futile. That the use of a definition as a starting point serves to obscure analysis and is a source of legal error is nowhere more evident than in the subject of letters of credit. Their variations are almost infinite. In the broadest sense, and a sense often used by the courts, a letter of credit is any letter whereby the writer arranges for some other person to obtain credit.[2] But in mercantile language the term has a much narrower meaning, and is coming more and more to have a connotation which is definite, restricted, and precise. The commercial letter of credit is most commonly used in connection with the sale of goods. For the purpose of this article the discussion will be confined to letters which are so used. Such letters may be best understood by a consideration of their object, which is to enable the seller of goods

[2] The orthodox legal definition is to be found in STORY, BILLS OF EXCHANGE, 3 ed., § 459 (1853). See also BYLES, BILLS OF EXCHANGE, 16 ed., p. 111 (1899); CHALMERS, BILLS OF EXCHANGE, 6 ed., pp. 183–184 (1903); 2 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., § 1790 (1914); 18 AMERICAN AND ENGLISH ENCYCLOPAEDIA OF LAW, 2 ed., p. 831; BLACK, LAW DICTIONARY, Tit. "Letter of Credit"; BOUVIER, LAW DICTIONARY, Tit. "Letter of Credit"; American Steel Co. *v.* Irving National Bank, 266 Fed. 41, 43 (1920); Liggett and Levy *v.* Union National Bank, 233 Mo. 590, 136 S. W. 299 (1911); Bank of Montreal *v.* Thomas, 16 Ont. 503 (1888); Bissell *v.* Lewis, 4 Mich. 450 (1857); Union Bank of Louisiana *v.* Coster, 3 N. Y. 203 (1850); Birckhead *v.* Brown, 5 Hill (N. Y.) 634 (1843), 2 Den. (N. Y.) 375 (1845). For a judicial dissent from this orthodox definition see Van Brunt, P. J., in Johannessen *v.* Munroe, 84 Hun, (N. Y.) 594 (1895).

to obtain cash upon shipment, or to discount a draft for the purchase price rather than to deposit for collection. The letter is therefore designed to assure the seller that cash will be paid, or to authorize a designated person to draw bills of exchange and to enable the seller to show this authority in order to discount the drafts, or simply to assure the seller that the drafts will be purchased. It is therefore common to provide authority for the drawing of drafts upon some person whose financial standing is better known than the buyer's. In most cases this is a bank, and the credit is in consequence often called a *bank credit.* Commercial letters of credit are, however, by no means confined either to those which provide for the drawing of drafts on some person other than the buyer or to those which are written by bankers.

A commercial letter of credit may roughly be said to be:

(1) Any letter whereby the writer authorizes some other person to draw bills of exchange on the writer or upon some designated third person and undertakes either expressly or by implication that drafts drawn in compliance with the terms of the letter will be accepted and paid. The credit in connection with which this letter is used is known as the *acceptance credit.* It is the normal letter of credit transaction.

(2) Any letter whereby the writer agrees to pay, or undertakes that some other person will pay, a designated amount of money, in cash, for specified shipping documents. The credit in connection with which this letter is used is known as the *cash credit.* The money is paid without the interposition of an acceptance or discount of a bill of exchange. In other respects it is the same as the acceptance credit. It is not the normal letter of credit transaction.

(3) Any letter whereby the writer agrees to purchase drafts drawn upon a designated person. The credit in connection with which this letter is used is known as the *negotiation credit.* It is less common than either the acceptance or the cash credit.

Mercantile writers tend to exclude the cash credit from the subject of letters of credit, and to confine letters of credit to those letters used in connection with the acceptance credit.[3] Many writers, however, include in the subject of letters of credit those

[3] See WHITAKER, p. 131; HOUGH, pp. 544–546; U. S. DEPT. OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 131; SILVER, p. 84; SPALDING, p. 147; ESCHER, FOREIGN TRADE EXPLAINED, pp. 109, 143; PRECIADO, pp. 280, 287.

letters used in connection with the negotiation credit. The business principle of the cash credit is in every respect the same as the principle of the acceptance credit. The discussion in this article will therefore be confined to those letters used in connection with the negotiation and the acceptance credits, more particularly the latter.

A letter of credit may be clean or documentary. A *clean letter of credit* provides for an acceptance or negotiation of a draft unaccompanied by shipping documents. A *documentary letter of credit* provides for an acceptance or negotiation of a draft accompanied by shipping documents. The *documentary acceptance letter of credit* is the type in ordinary use.

In mercantile language, the person who arranges for the credit and procures the letter of credit is known as the *applicant for the credit* (he is usually the buyer of the goods); the person who is to draw the drafts, or to whom cash is to be paid, is known as the *beneficiary of the credit* (he is usually the seller of the goods); the writer of the letter of credit is known as the *issuer* or *credit-issuing bank;* the person upon whom the drafts are to be drawn is known as the *drawee* or *accepting bank;* the person who is to discount the drafts is known as the *draft-buying* or *negotiating bank.* The beneficiary is the *accredited party.* The negotiating bank is the *accrediting party.*[4]

In judicial language, the writer is sometimes spoken of as the *issuer;* the person in whose behalf the letter of credit is issued, as the *holder;* and the person to whom it is written, as the *addressee.*[5] But such terminology is neither illuminating nor conducive to clear analysis. The writer may be the buyer or he may be some person other than the buyer; the writer may be the drawee bank or he may be some other bank. The term *holder* is misleading for two reasons: first, because, although the letter is usually delivered to the person at whose behest it is written, it is often sent directly by the writer to the person to whom it is written without the interposition of the person on whose behalf it was issued; and secondly, because the term *holder* has a technical meaning in the law of bills

[4] As between the credit-issuing bank, the beneficiary of the credit, and the negotiating bank the negotiating bank is the accrediting party. It is in this sense that the term is here used.

[5] See Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1 (1918).

and notes. The term *addressee* is the most confusing and useless of the three, for the letter may be written to the buyer, or to the seller, or to the person upon whom the drafts are to be drawn, or to the world at large, and it may be sent to one other than the person to whom it is ostensibly written. The essential inquiry analytically is, To whom is the promise made?

Since the commercial letter of credit is used chiefly to facilitate payments under sales contracts, it seems desirable for the sake of clearness of analysis to combine the terminology of the sales contract with the mercantile terminology of letters of credit and to use the following terms:

Buyer. This is the person to whom the goods are sold under the sales contract. Generally, he is the *applicant for the credit.*

Seller. This is the person by whom the goods are sold under the sales contract. Generally, he is the *beneficiary of the credit* and the *accredited party.*

Credit-opening bank. This is the individual or firm with which the applicant for the credit arranges for the issuing of the letter of credit.

Issuing bank. This is the individual or firm, other than the buyer, that writes the letter of credit.

Drawee bank. This is the individual or firm, other than the buyer, upon which the drafts under the letter of credit are to be drawn.

Purchasing bank, or *purchaser*. This is the individual or firm which discounts the drafts drawn under the letter of credit. It is the *accrediting party*.

These terms will be used throughout this article.

TYPES OF COMMERCIAL LETTERS OF CREDIT

The mechanism of the letter of credit method of financing shipments, the nature of the transaction, and the relation of the parties are best understood through an examination of the ways in which it is employed. Commercial letters of credit may be classified functionally [6] under three types: letters written by the buyer; letters written by some one other than the buyer; combinations of these two used in conjunction.

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[6] For a different classification see Hershey, *op. cit.*

1. Letters Written by the Buyer

A few examples of letters written by the buyer may be noted. The list is not intended to be exhaustive.

(1) The letter is written to the seller and authorizes him to draw bills of exchange in a specified manner on the buyer.[7]

(2) The letter is addressed to whom it may concern and authorizes the seller to draw on the buyer.[8]

(3) The letter is written either to the seller or to whom it may concern and authorizes the seller to draw in a specified manner upon a designated third person. The buyer undertakes that the drafts will be accepted and paid. It is sent to the seller.

(4) The letter is addressed to a third person and authorizes the seller to draw on the third person and the third person to accept and pay. It may be sent to the seller, or to the third person, or a copy may be sent to each.[9]

(5) The letter is addressed to a third person and authorizes the third person to purchase specified drafts which the seller will draw on the buyer.[10] The buyer undertakes to accept and pay.

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[7] This form was used in the following cases: Putnam National Bank *v.* Snow, 172 Mass. 569, 52 N. E. 1079 (1899); Exchange Bank *v.* Hubbard, 62 Fed. 112 (1894); Nevada Bank *v.* Luce, 139 Mass. 488, 1 N. E. 926 (1885); Allen *v.* Hornor, 2 McGloin (La.) 177 (1884); First National Bank of Flora *v.* Clark, 61 Md. 400 (1883); Young *v.* Lehman, 63 Ala. 519 (1879); Franklin Bank of Baltimore *v.* Lynch, 52 Md. 270 (1879); Second National Bank *v.* Diefendorf, 90 Ill. 396 (1878); Miltenberger *v.* Cooke, 18 Wall. (U. S.) 241 (1873); Smith *v.* Ledyard, 49 Ala. 279 (1873); Merchants' Exchange National Bank *v.* Cardozo, 35 N. Y. Sup. Ct. 162 (1872); Exchange Bank of St. Louis *v.* Rice, 98 Mass. 288 (1867); Vallé *v.* Cerré's Adm'r, 36 Mo. 575 (1865); Lugrue *v.* Woodruff, 29 Ga. 648 (1860); Bissell *v.* Lewis, 4 Mich. 450 (1857); Lewis *v.* Kramer, 3 Md. 265 (1852); Forman *v.* Walker, 4 La. Ann. 409 (1849); Lonsdale *v.* Lafayette Bank, 18 Ohio, 126 (1849); Nisbett *v.* Galbraith, 3 La. Ann. 690 (1848); Murdock *v.* Mills, 11 Metc. (Mass.) 5 (1846); Ulster County Bank *v.* McFarlan, 3 Den. (N. Y.) 553 (1846); Worcester Bank *v.* Wells, 8 Metc. (Mass.) 107 (1844); Michigan Bank *v.* Ely, 17 Wend. (N. Y.) 508 (1837); Parker *v.* Greele, 5 Wend. (N. Y.) 414 (1830); Lanusse *v.* Barker, 3 Wheat. (U. S.) 101 (1818); Urquhart *v.* M'Iver, 4 Johns. (N. Y.) 103 (1809).

[8] Merchants' Bank of Canada *v.* Griswold, 72 N. Y. 472 (1878).

[9] This is similar to the agreement which the buyer signs for Type 3 letters of credit. See *infra*, pp. 551–553.

[10] This form was used in the following cases: Wilson & Co. *v.* Niffenegger, 211 Mich. 311, 178 N. W. 667 (1920); American National Bank *v.* Pillman, 176 Mo. App. 430, 158 S. W. 433 (1913); Bank of Beaver County *v.* Bradstreet, 89 Neb. 186, 130 N. W. 1038 (1911); Baeschlin *v.* Chamberlain Banking House, 67 Neb. 196, 93 N. W. 412 (1903); Lyon *v.* Van Raden, 126 Mich. 259, 85 N. W. 727 (1901); Burke *v.* Utah

The writer may attach whatever conditions he pleases. He may state as conditions precedent to acceptance and payment that the shipping documents accompany or be attached to the draft, that the acceptor or purchasing bank make a notation of the letter on the draft and of the draft on the letter, and he may expressly limit the duration of the authority and the maximum amount for which drafts may be drawn. The requirements of the buyer are thus met. But a letter written by a buyer, unless he is well known, adds but little to the marketability of the draft. Consequently this type of letter is of slight importance in international trade. Its use is confined to domestic commerce, where it is most frequently employed by principals in the case of their purchasing agents.

2. *Letters Written by Some One Other than the Buyer*

A few illustrative examples of letters written by some one other than the buyer may be noted. In this connection it is immaterial to inquire into the motives of the writer, or to ask whether there was any agreement between the writer and the person to whom title to the goods passed.

(1) The letter is addressed to the seller. It requests that goods be furnished the buyer. The writer undertakes to pay the purchase price.[11]

(2) The letter is addressed to the seller, and requests that goods be furnished the buyer. The writer undertakes to pay the purchase price in case the buyer does not pay.[12]

National Bank, 47 Neb. 247, 66 N. W. 295 (1896); Union Bank *v.* Shea, 57 Minn. 180, 58 N. W. 985 (1894); Palmer *v.* Rice, 36 Neb. 844, 55 N. W. 256 (1893); First National Bank *v.* Fiske, 133 Pa. St. 241, 19 Atl. 554 (1890); Hall *v.* First National Bank, 35 Ill. App. 116 (1889), 133 Ill. 234, 24 N. E. 546 (1890); First National Bank *v.* Bensley, 2 Fed. 609 (1880); Brinkman *v.* Hunter, 73 Mo. 172 (1880); White's Bank of Buffalo *v.* Myles, 73 N. Y. 335 (1878); Johnson *v.* Blakemore, 28 La. Ann. 140 (1876); Burns *v.* Rowland, 40 Barb. (N. Y.) 368 (1863); Dickins *v.* Beal, 10 Pet. (U. S.) 572 (1836); Boyce *v.* Edwards, 4 Pet. (U. S.) 111 (1830).

[11] This form was used in the following cases: Fletcher Guano Co. *v.* Burnside, 142 Ga. 803, 83 S. E. 935 (1914); Krakauer *v.* Chapman, 16 App. Div. 115, 45 N. Y. Supp. 127 (1897); Cheever *v.* Schall, 87 Hun (N. Y.) 32 (1895); Smith *v.* Montgomery, 3 Tex. 199 (1848); Kennedy *v.* Geddes, 3 Ala. 581 (1842); Lienow *v.* Pitcairn, Fed. Cas. No. 8,341 (1832); Edmonston *v.* Drake, 5 Pet. (U. S.) 624 (1831); Sollee *v.* Meugy, 1 Bailey Law (S. C.) 620 (1830); Walsh and Beekman *v.* Bailee, 10 Johns. (N. Y.) 180 (1813); Grant *v.* Naylor, 4 Cranch (U. S.) 224 (1808).

[12] This form was used in the following cases: Holmes *v* Schwab & Sons, 141 Ga. 44, 80 S. E. 313 (1913); Crane Co. *v.* Specht, 39 Neb. 123, 57 N. W. 1015 (1894);

(3) The letter is the same as subtypes (1) and (2) except that it is addressed to whom it may concern. It is delivered to the buyer.[13]

(4) The letter is addressed to the buyer (or to the seller) and authorizes the buyer to draw specified drafts in favor of the seller which the writer undertakes to accept and pay.[14]

(5) The letter is addressed to the buyer and authorizes him to draw on the writer, who undertakes to honor the drafts.[15]

(6) The letter is addressed to the seller and authorizes him to draw on the writer who undertakes to honor the drafts.[16]

(7) The letter is addressed to whom it may concern (or to the seller, or to a third person) and authorizes the seller to draw on a third person drafts which the writer undertakes will be accepted and paid.[17]

(8) The letter is addressed to whom it may concern and authorizes the buyer (or the seller) to draw specified drafts on the writer who undertakes to honor them.[18]

(9) The letter is addressed to the seller (or to the buyer, or to a third person, or to whom it may concern) and promises to purchase specified drafts.[19]

Taylor *v.* Wetmore, 10 Ohio, 490 (1841); Adams *v.* Jones, 12 Pet. (U. S.) 207 (1838); Douglass *v.* Reynolds, 7 Pet. (U. S.) 113 (1833); Robbins *v.* Bingham, 4 Johns. (N. Y.) 476 (1809).

[13] This form was used in the following cases: Johnson *v.* Brown, 51 Ga. 498 (1874); Lawrason *v.* Mason, 3 Cranch (U. S.) 492 (1806).

[14] This form was used in the following cases: Sigel-Campion Live Stock Commission Co. *v.* Davis, 69 Colo. 511, 194 Pac. 468 (1921); People's Saving Bank & Trust Co. *v.* Landstreet, 87 So. 227 (Fla., 1920); North Atchison Bank *v.* Garretson, 51 Fed. 168 (1892); Lindley *v.* First National Bank, 76 Iowa, 629, 41 N. W. 381 (1889).

[15] This form was used in the following cases: Springfield Bank *v.* Mitchell, 48 Ill. App. 486 (1892); Ranger *v.* Sargent, 36 Tex. 26 (1871); Nelson *v.* First National Bank, 48 Ill. 36 (1868); Monroe *v.* Pilkington, 14 How. Pr. (N. Y.) 250 (1857).

[16] This form was used in the following cases: Brown *v.* Ambler, 66 Md. 391, 7 Atl. 903 (1887); Lockwood *v.* Brownson, 53 Tex. 523 (1880); Young *v.* Lehman, 63 Ala. 519 (1879); Ilsley *v.* Jones, 12 Gray (Mass.) 260 (1858).

[17] This form was used in the following cases: Cutler *v.* American Exchange National Bank, 113 N. Y. 593, 21 N. E. 710 (1889); Evansville National Bank *v.* Kaufmann, 93 N. Y. 273 (1883); Pollock *v.* Helm, 54 Miss. 1 (1876); Omaha National Bank *v.* First National Bank, 59 Ill. 428 (1871).

[18] This form was used in the following cases: Bank of Seneca *v.* First National Bank of Carthage, 105 Mo. App. 722, 78 S. W. 1092 (1904); Roman *v.* Serna, 40 Tex. 306 (1874); Union Bank *v.* Coster, 3 N. Y. 203 (1850).

[19] This is the same as the authority to draw and the letter of advice discussed *infra*, pp. 549–551.

The writer may attach conditions in respect to goods, drafts, shipping documents, duration of time, and the like. These numerous sub-types are given for the purpose of showing the great variety of forms which they may take.

3. Letters Written by the Buyer and Letters Written by Some One Other than the Buyer used in Combination

The combinations of the sub-types of the first and second types may be numerous. There are, however, five combinations which are in common use. These combinations give rise to certain letters which are employed to such an extent, especially in export and import trade, that the designation *letter of credit* is coming to be used among merchants and bankers to refer to them exclusively. It is with these well-recognized and understood letters, in reference to which the term *letter of credit* has a fairly definite and exclusive meaning, that this article will deal. These five letters are: (1) authority to purchase drafts, (2) direct import letter of credit, (3) indirect import letter of credit, (4) direct export letter of credit and advice of credit opened, and (5) seller's export letter of credit.

(1) *Authority to purchase drafts.*[20] This letter is used to facilitate the trade acceptance. The buyer issues to his local bank a letter which states that the seller has authority to draw drafts on the buyer, requests the bank to buy the drafts, promises to accept and pay them, and sometimes requests further that the bank arrange for some bank in the seller's country to purchase the drafts in the first instance. This letter is known as an *authority to draw.*[21] It contains a definite description of the drafts to be drawn and of

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[20] See WOLFE, p. 241.

[21] See SPALDING, p. 152; WHITAKER, p. 173; HOUGH, p. 547.

The buyer's authority is sometimes called an *importer's guaranty to bankers*. See HOUGH, p. 548. These forms vary in minor respects among bankers. A typical form is given below:

FORM OF AUTHORITY TO DRAW.

"To . . . [Here insert name of Issuing Bank] . . .

DEAR SIRS: In consideration of your negotiating drafts to be drawn by . . . [Here insert name of the seller] . . . on . . . [Here insert the name of the buyer] . . . [Here follows a description of the drafts] . . . I hereby agree to accept and pay the said drafts. The drafts must be accompanied by . . . [Here follows a description of the shipping documents]. . . .

[Here follows a power of sale to the bank]. It is expressly agreed that the Issuing

the shipping documents to be attached. The bank may then write a *letter of advice* directly to the seller and inform him that it will buy the drafts when presented.[22] Or it may send to another bank, the purchasing bank, in the country where the seller resides, a letter requesting it to purchase the drafts. This letter is known as an *authority to purchase drafts*.[23] The purchasing bank, thus authorized, may then communicate with the seller by means of a letter of advice.

The credit in connection with which these letters are used is known as the *negotiation credit.* These authorities to draw and to purchase and letters of advice are considered by the business world as creating no binding obligations from the moment of issue. They

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Bank assumes no liability in respect to forged or altered shipping documents or defects in quality or quantity of the goods.

It is understood that negotiation of the said drafts shall be optional on the part of the Issuing Bank.

(Signed) . . . [name of buyer]. . . ."

[22] This letter is sometimes called a *banker's authority to draw.* See HOUGH, p. 528. More properly it is a *letter of advice* or *instruction.*

FORM OF THE BANKER'S LETTER OF ADVICE USED IN CONNECTION WITH THE AUTHORITY TO PURCHASE AND THE AUTHORITY TO DRAW.

"To . . . [Here insert the name of the seller] . . .

DEAR SIR: We are instructed to purchase your drafts drawn on . . . [Here insert the name of the buyer] . . . [Here follows a description of the drafts] . . . accompanied by . . . [Here follows a description of the shipping documents].

Please note that this is not to be considered as being a bank credit and does not relieve you from the liability usually attaching to the drawer of a bill of exchange, also that although it is to be considered to be open for . . . from date it may be cancelled by us upon giving you notice.

(Signed) . . . [here insert name of Issuing Bank]. . . ."

The negotiation credit may be requested *with recourse,* in which case the bank has recourse against the seller as drawer, or *without recourse.* The form given is the negotiation credit with recourse. This is the usual form. See WOLFE, pp. 414, 420.

[23] The form is similar to the authority to draw set forth *supra,* note 21, with some modifications. See WHITAKER, p. 175; HOUGH, p. 528; WOLFE, p. 420.

For cases where the negotiation credit was involved see: Bank of Plant City *v.* Canal-Commercial Trust and Savings Bank, 270 Fed. 477 (1921); Lemon Importing Co. *v.* Garfield Savings Bank, 187 App. Div. 932, 105 Misc. 627, 173 N. Y. Supp. 551 (1919); Friedlander *v.* Bank of Australasia, 8 C. L. R. (H. C. Australia) 85 (1909); Basse and Selve *v.* Bank of Australasia, 90 L. T. R. 618 (1904); Borthwick *v.* Bank of New Zealand, 17 T. L. R. 2 (1900); Burke *v.* Utah National Bank, 47 Neb. 247, 66 N. W. 295 (1896); Palmer *v.* Rice, 36 Neb. 844, 55 N. W. 256 (1893); Hall *v.* First National Bank, 133 Ill. 234, 24 N. E. 546 (1890); White's Bank of Buffalo *v.* Myles, 73 N. Y. 335 (1878); Pollock *v.* Helm, 54 Miss. 1 (1876); Waterston *v.* Edinburgh and Glasgow Bank, 20 Ct. Sess. 642 (1858); Orr & Barber *v.* Union Bank of Scotland, 1 Macq. 513 (1854).

are regarded as revocable or subject to modification at any time prior to the presentation of the drafts for negotiation.[24] Indeed, they usually contain an express clause to this effect.

(2) *Direct import letter of credit.* This letter is so called because it is issued by a bank in the buyer's country, at the request of the buyer, for the purpose of facilitating importation of merchandise, and authorizes the seller to draw directly upon the issuing bank.

A concrete case will best show its use. The buyer, the American Importing Company of New York, and the seller, the British Exporting Company of London, are contemplating a sale of goods. The American Importing Company wishes to postpone actual payment for ninety days after the goods are shipped. By that time the merchandise will have arrived in New York, will have been delivered to the buyer, and resold. The goods will thus be made to pay for themselves without any outlay of capital on the part of the Importing Company. The British Exporting Company, on the other hand, wishes to be paid in cash as soon as the goods are shipped. Generally the sales contract is made first and stipulates that the buyer shall procure[25] either an irrevocable or a revocable letter of credit in favor of the seller from the buyer's local bank, the Issuing Bank of New York; or sometimes in contemplation of making the sales contract the buyer will procure the letter of credit in advance.[26]

The Importing Company accordingly applies to the Issuing Bank for a direct import letter of credit. The buyer signs and delivers to the bank a written statement containing four main provisions:[27] first, the buyer agrees to the terms of the letter of

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[24] See WHITAKER, pp. 176–178.

[25] Bank of Taiwan, Ltd. *v.* Gorgas-Pierie Mfg. Co., 273 Fed. 660 (1921); Imbrie *v.* D. Nagase & Co., Ltd., 187 N. Y. Supp. 692 (1921); Parker *v.* Simon, 194 App. Div. 342, 185 N. Y. Supp. 339 (1920); Frey & Son *v.* Sherburne Co. and the National City Bank, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920); Lemon Importing Co. *v.* Garfield Savings Bank, 187 App. Div. 932, 105 Misc. 627, 173 N. Y. Supp. 551 (1919); Hindley & Co. *v.* Tothill, Watson & Co., 13 N. Z. L. R. 13 (C. A. 1894). See ESCHER, FOREIGN TRADE EXPLAINED, p. 123. See also UNITED STATES DEPARTMENT OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 134.

[26] Roman *v.* Serna, 40 Tex. 306 (1874); Edmonston *v.* Drake, 5 Pet. (U. S.) 624 (1831).

[27] See MARGRAFF, pp. 91–92; ESCHER, FOREIGN TRADE EXPLAINED, pp. 113, 149; WHITAKER, pp. 132, 148; SILVER, p. 192; BROOKS, p. 176. This form varies slightly among bankers. A typical form is the following:

credit issued by the bank; secondly, in consideration of the issue of the letter of credit he agrees further to pay the bank in a specified

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FORM OF BUYER'S AGREEMENT.

"To . . . [name of Issuing Bank] . . .

DEAR SIRS: In consideration of your issuing at the request of the undersigned your (Revocable) (Irrevocable) Letter of Credit No. . . . as per copy on reverse side, we hereby agree to its terms and bind ourselves to pay to you in cash at . . . on demand, the amount of each draft drawn at sight thereunder plus interest at the prevailing rate when required, or the amount of each acceptance made thereunder at least one day prior to the maturity of such acceptance or on demand, and in either case your commission at the rate of . . . per cent, on such part as may be used, and any and all charges and expenses.

The undersigned hereby authorize you to charge their account with you with any and all amounts that may at any time or times be owing from them to you hereunder or otherwise.

In the absence of written instructions to the contrary, the undersigned hereby authorize you to accept as "bills of lading" under the said credit, any documents issued by or on behalf of any carrier, including lighterage receipts, which acknowledge receipt of goods for transportation, whatever the other specific provisions of such documents, and the date of every such document is to be regarded as the date of "shipment" within the said credit.

Neither you nor your correspondents shall be responsible for the acts of the beneficiaries of the said credit, nor for the character, kind, quality, quantity, delivery, or existence of the merchandise purporting to be represented by the documents; nor for any difference in character, kind, quality, quantity of merchandise purporting to be imported under this credit from that expressed in the invoice accompanying the drafts; nor for the validity, genuineness, sufficiency, form or correctness of documents, even if such documents should, in fact, prove to be in any or all respects incorrect, defective, irregular, fraudulent, or forged; nor for the time, place, manner or order in which shipment is made; nor for partial or incomplete shipments; nor for the kind, covering, character, adequacy, validity, or genuineness of any insurance or the solvency or responsibility of any insurer or any other risk connected with insurance; nor for any default, delay, fraud, or deviation from instructions of the shipper or any one else in connection with the said merchandise, the shipping thereof, or the shipping or any other documents with respect thereto; nor for delay in arrival or failure to arrive either of the merchandise or of any documents; nor for errors, omissions, interruptions or delays in the transmission or delivery of messages by mail, cable, telegraph or wireless, whether or not the same be in cipher; nor for any other cause beyond your control. The undersigned agree to procure promptly all necessary import, export, or other licenses for the said merchandise, and will keep the same adequately covered by policies of fire, marine and war risk insurance in companies satisfactory to you, assigning the policies or the certificates of insurance to you or making the loss or adjustment, if any, payable to you at your option.

Legal title to all merchandise shipped under the said credit shall be and remain in you until advances made by you have been paid, and the bills of lading, policies of insurance and other documents relating to the same and any or all other funds, property or securities, including also any or all collection items and proceeds thereof, now or hereafter handed to you or for any purpose left in your possession by the undersigned or for their account are hereby made security for this obligation and also for

manner the amount of the drafts drawn under the letter of credit at least one day before they become due, together with a specified commission; thirdly, the buyer agrees that the bank shall hold legal title to the goods as security until the amounts due from the buyer to the bank shall have been paid, that additional security shall be furnished on demand, and that the bank shall have power to sell and pledge the merchandise; and fourthly, this statement may contain express clauses to the effect that the buyer will hold the bank to no responsibility in respect to invalid bills of lading, defects in quality and quantity of the goods, and the like. Actual cash is practically never paid by the buyer for the letter of credit. Nor is a present loan arranged. The commission may, however, be paid in advance.[28]

The bank then issues its letter of credit,[29] which may be addressed

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any and all other obligations or liabilities, absolute or contingent, due or not due, which are or may hereafter be owing by the undersigned to you, all of which, in the event of default by the undersigned in any part thereof, or of bankruptcy, insolvency, receivership, or general assignment of the undersigned, shall forthwith become due and payable; and the undersigned agree, whenever the security aforesaid shall seem to you insufficient, to furnish you on your request additional security to your satisfaction, and hereby authorize you, if at any time they fail to do so, or if any obligation covered by this instrument remains unpaid when due, forthwith, without further demand or notice or advertisement of any kind, all of which are hereby expressly waived, to sell the whole or any part of such merchandise, property, or other security arrived or to arrive, at any broker's exchange or at public or private sale, at your option, and yourselves to become the purchasers in whole or part, without accountability save for the purchase price and free from any right of redemption which is hereby waived and released; and to apply the net proceeds of such merchandise or security against any or all obligations or liabilities of the undersigned to you, howsoever arising.

The obligations hereof shall continue in force notwithstanding any change in the membership of any partnership of the undersigned, whether arising from the death or retirement of one or more partners, or from the accession of one or more new partners.

This letter of credit can be revoked only with the consent of all parties in interest. [This clause is modified accordingly if the letter of credit is to be in the revocable form.]

(Signed) . . . [name of the buyer] . . . ."

[28] See *Ex parte* Agra Bank, *In re* Barber & Co., L. R. 9 Eq. 725 (1870); *In re* Agra Bank, *Ex parte* Tondeur, L. R. 5 Eq. 160 (1867).

[29] See York, p. 137; Whitaker, p. 132; Wolfe, p. 422; Silver, p. 191; Spalding, p. 148; U. S. Dept. of Commerce, Paper Work in Export Trade, p. 131.

This form varies slightly among banks.

Form of Direct Import Letter of Credit.

"To . . . [Name of seller] . . .

Dear Sir: At the request and for the account of . . . [Name of buyer] . . . we hereby authorize you to value on [the Issuing Bank] at . . . for any sum or sums not exceeding a total of . . . accompanied by commercial invoice, consular invoice,

to the British Exporting Company [30] or to the American Importing Company.[31] It is generally addressed, however, directly to the seller. It contains seven main provisions: first, it states that it has been issued at the request and for the account of the American Importing Company in reference to a specified sales contract; secondly, it authorizes the seller to draw bills of exchange on the Issuing Bank at ninety days after sight or date not to exceed in all a specified amount; thirdly, it states the requirements in respect to the shipping documents; fourthly, it sets a time limit within which the drafts must be presented for acceptance; fifthly, it specifies that all drafts drawn under the letter must be indorsed by

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bills of lading . . . representing . . . shipment of . . . insurance . . . Bills of lading for such shipment must be drawn to the order of . . . A copy of the invoice, consular invoice and one bill of lading must be sent by the bank negotiating drafts direct to . . . attaching to the draft a statement to that effect. The amount of each draft negotiated must be indorsed hereon. Drafts drawn under this credit must bear the clause 'drawn under letter of credit no. . . . dated . . .'"

We hereby agree with the drawer and bona fide holders that all drafts drawn by virtue of this credit, and in accordance with the above stipulated terms, shall meet with due honor upon presentation at the Issuing Bank if drawn and negotiated on or before . . . .

Respectfully yours,

(Signed) . . . [Issuing Bank.] . . ."

[30] In the following cases the letter of credit was addressed to the seller and conferred authority upon the seller to draw on the issuing bank: International Banking Corporation *v.* Irving National Bank, 274 Fed. 122 (1921); Bank of Taiwan, Ltd. *v.* Gorgas-Pierie Mfg. Co., 273 Fed. 660 (1921); Imbrie *v.* D. Nagase & Co., 187 N. Y. Supp. 692 (1921); American Steel Co. *v.* Irving National Bank, 266 Fed. 41 (1920); Frey & Son *v.* Sherburne Co. and the National City Bank, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920); Moers *v.* Den Norske Handelsbank, 191 App. Div. 114, 180 N. Y. Supp. 743 (1920); Hindley & Co. *v.* Tothill, Watson & Co., 13 N. Z. L. R. 13 (C. A. 1894); *Ex parte* Dever, *In re* Suse, 13 Q. B. D. 766 (C. A. 1884); Lockwood *v.* Brownson, 53 Tex. 523 (1880); Gelpcke *v.* Quentell, 74 N. Y. 599 (1878); *In re* Barned's Banking Co., Banner & Young *v.* Johnston, L. R. 5 H. L. 157 (1871); *Ex parte* Agra Bank, *In re* Barber & Co., L. R. 9 Eq. 725 (1870); *In re* Barned's Banking Co., Coupland's Claim, L. R. 5 Ch. App. 167 (1869); *In re* Agra and Masterman's Bank, *Ex parte* Asiatic Banking Corporation, L. R. 2 Ch. App. 391 (1867); Baring *v.* Lyman, Fed. Cas. No. 983 (1841).

[31] In the following cases the letter of credit was addressed to the buyer and conferred authority upon the buyer to draw on the issuing bank: Kuehne *v.* Union Trust Co., 133 Mich, 602, 95 N. W. 715 (1903). (This is the normal type of the traveler's letter of credit.) Chartered Bank of India, Australia & China *v.* Macfayden & Co., 64 L. J. Q. B. 367 (1895); Craig *v.* Marx, 65 Tex. 649 (1886); Roman *v.* Serna, 40 Tex. 306 (1874); Monroe *v.* Pilkington, 14 How. Pr. (N. Y.) 250 (1857).

In the following cases the letter of credit was addressed to the buyer and conferred authority upon the seller to draw on the issuing bank: Prehn *v.* Royal Bank of Liverpool, L. R. 5 Ex. 92 (1870); Bell *v.* Moss, 5 Whart. (Pa.) 189 (1840).

purchasers on the letter and the number of the letter must be indorsed on the drafts; sixthly, it agrees with all *bona fide* holders of drafts drawn in compliance with the terms of the letter of credit that they will be honored; seventhly, it contains an express provision to the effect that it is irrevocable or revocable, as the case may be. The Issuing Bank may send this letter directly to the seller, but it is usual for it to deliver the letter to the buyer, who sends it to the seller.

Upon receipt of the letter of credit the Exporting Company proceeds with the manufacture of the goods, ships them, takes out the required shipping documents, and presents the drafts, together with the shipping documents and the letter of credit, to a local bank, the purchasing bank, for discount. This bank purchases the draft. If the sales contract provides for several shipments at intervals of time, and the letter of credit provides for drafts to correspond to these shipments, the purchasing bank will make the proper notation on the draft and on the letter of credit and return the letter to the seller. But if the shipment is the only or final shipment, the purchasing bank will take up the letter, cancel it, and attach it to the other documents. The papers are forwarded to the Issuing Bank, which accepts the drafts and detaches the shipping documents. When the goods arrive in New York the bank surrenders them to the buyer on some arrangement, usually on a trust receipt or on a bailee (more properly agency) receipt.[32] The American Importing Company then proceeds to resell the goods. When the time arrives for putting the Issuing Bank in funds the Importing Company will have the proceeds from the resales.[33] It pays the bank in the manner provided. The draft then falls due and is paid by the bank; but payment by the bank is in no respect conditioned in business understanding upon previous performance of the buyer's agreement.

Thus, neither the buyer nor the issuing bank uses cash or its equivalent in the letter of credit transaction. The purchasing bank advances the actual money. The issuing bank lends its credit, not its funds, in return for a commission.

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[32] See WHITAKER, p. 160.

[33] Usually, under a trust receipt or agency receipt, the proceeds from the sale of the goods are turned over to the bank as fast as the goods are resold. The arrangement modifies to this extent the previous letter of credit arrangement.

The credit in connection with which the direct import letter of credit is used may be either the *acceptance credit* or the *cash credit.* The credit which has been described is the acceptance credit, which is the normal letter of credit transaction. The business transaction of the cash credit is the same in principle as the acceptance credit. The only difference is that the issuing bank undertakes to pay the seller cash on certain conditions without the interposition of the acceptance of a bill of exchange. In the cash credit there is no purchasing bank or accrediting party. It is not the normal letter of credit transaction.

Two banks are usually involved in the direct import acceptance letter of credit transaction. The credit-opening bank, the issuing bank, and the drawee bank coincide. The second bank is the purchasing bank. The drafts may be presented, however, directly by the drawer for acceptance, in which case the purchasing bank is eliminated from the letter of credit transaction, although it may subsequently discount the accepted draft.

The direct import letter of credit may be issued in two forms: *revocable* and *irrevocable.* The revocable letter of credit expressly states that it is revocable. It is regarded by merchants and bankers as revocable or subject to modification at any time before drafts drawn under it are negotiated, or, in the case that the seller presents the drafts for acceptance, at any time prior to presentation. It is the practice, however, of most banks to issue the direct import letter of credit only in the irrevocable form. The irrevocable letter of credit is regarded as creating a binding obligation from the moment of issue, and subject to revocation or modification only with the consent of all the parties concerned.[34]

(3) *Indirect import letter of credit.* The business transaction is the same as that discussed under the direct import letter of credit with the following exceptions. The sales contract provides for a letter of credit issued by a bank in the buyer's country authorizing the seller to draw on some bank in his own country. The buyer agrees to put the issuing bank in funds at least twelve or fifteen days prior to the maturity of the drafts, and, in case the other bank is asked to confirm the credit, to pay an additional commission. The issuing bank accordingly, instead of authorizing

[34] See WHITAKER, p. 169.

the seller to draw on itself, issues a letter of credit which authorizes him to draw on another named bank, the drawee bank.[35] This letter may be sent by the issuing bank directly to the seller,[36] or it may be sent to the drawee bank,[37] or it may be delivered to the buyer and by him sent to the seller.[38] But it is usual to issue this letter in four parts.[39] Two copies are given to the buyer. One of these he retains; the other he forwards to the seller. The issuing bank retains one copy and sends the fourth copy to the drawee bank.

Three banks are usually involved in the indirect import letter

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[35] This type of letter of credit is frequently called a sterling letter of credit because it usually authorizes the drawing upon an English bank. See WHITAKER, p. 136. The form is the same, with the necessary modification that drafts are to be drawn on the drawee bank and that the issuing bank promises that the drawee bank will accept and pay, as that set forth *supra*, note 29.

The letter of credit may be addressed to the drawee bank authorizing the seller to draw. Friedlander *v.* Bank of Australasia, 8 C. L. R. 85 (1909); Johannessen *v.* Munroe, 158 N. Y. 641, 53 N. E. 535 (1899); Cutler *v.* American Exchange National Bank, 113 N. Y. 593, 21 N. E. 710 (1889); Bank of Montreal *v.* Recknagel, 109 N. Y. 482, 17 N. E. 217 (1888); Lafargue *v.* Harrison, 70 Cal. 380, 11 Pac. 636 (1886); Ulster Bank *v.* Synnott, I. R. 5 Eq. 595 (1871); *In re* Agra Bank, *Ex parte* Tondeur, L. R. 5 Eq. 160 (1867); Woods *v.* Thiedemann, 1 H. & C. 478 (1862); Carnegie *v.* Morrison, 2 Metc. (Mass.) 381 (1841). See HOUGH, p. 544; ESCHER, ELEMENTS OF FOREIGN EXCHANGE, pp. 143–153; BROWN, p. 96; SILVER, pp. 198–201.

The letter may be addressed to the seller authorizing the seller to draw: Lamborn *v.* Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1921); Vaughan *v.* Massachusetts Hide Corporation, 209 Fed. 667 (1913); Munroe *v.* Bonanno, 16 App. Div. 421, 45 N. Y. Supp. 61 (1897); Gelpcke *v.* Quentell, 74 N. Y. 599 (1878); Maitland *v.* Chartered Bank, 38 L. J. Ch. 363 (1869); Brazilian & Portuguese Bank *v.* British & American Exchange Banking Corporation, 18 L. T. R. 823 (1868); Russell *v.* Wiggin, 2 Story 213 (1842). See ESCHER, FOREIGN EXCHANGE EXPLAINED, p. 110.

The letter may be addressed to the buyer authorizing the buyer to draw: Bank of Toronto *v.* Ansell, 7 R. L. 262 (1875); Duncan *v.* Edgerton, 19 N. Y. Super. Ct. (6 Bosw.) 36 (1860).

[36] Gelpcke *v.* Quentell, 74 N. Y. 599 (1878).

[37] Friedlander *v.* Bank of Australasia, 8 C. L. R. 85 (1909); Gelpcke *v.* Quentell, 74 N. Y. 599 (1878); Ulster Bank *v.* Synnott, I. R. 5 Eq. 595 (1871); Woods *v.* Thiedemann, 1 H. & C. 478 (1862).

[38] Johannessen *v.* Munroe, 158 N. Y. 641, 53 N. E. 535 (1899); Cutler *v.* American Exchange National Bank, 113 N. Y. 593, 21 N. E. 710 (1889); Bank of Montreal *v.* Recknagel, 109 N. Y. 482, 17 N. E. 217 (1888); Lafargue *v.* Harrison, 70 Cal. 380, 11 Pac. 636 (1886); Brazilian & Portuguese Bank *v.* British & American Exchange Banking Corporation, 18 L. T. R. 823 (1868); *In re* Agra Bank, *Ex parte* Tondeur, L. R. 5 Eq. 160 (1867); Russell *v.* Wiggin, 2 Story, 213 (1842); Carnegie *v.* Morrison, 2 Metc. (Mass.) 381 (1841).

[39] See MARGRAFF, p. 91; BROOKS, pp. 173–174.

of credit transaction. The credit-opening bank and the issuing bank coincide. The second bank is the drawee bank. The third bank is the purchasing bank. Where the credit is a cash credit, or where the credit is an acceptance credit but the drawer presents the drafts for acceptance, the purchasing bank is eliminated from the letter of credit transaction.

The indirect import letter of credit may be issued either in the revocable or in the irrevocable form,[40] but it is customary to issue it only in the irrevocable form.

It may happen that the relation of principal and agent does not exist between the issuing and drawee banks.[41] There may be simply prior business dealings between them. The drawee bank may, however, be the agent of the issuing bank,[42] or the issuing bank may be the agent of the drawee bank.[43] The letter may purport to be issued solely on behalf of the issuing bank,[44] or solely on behalf of the drawee bank,[45] or it may purport to be issued by the issuing bank on its own behalf as agent as well as on behalf of the drawee bank as principal, and to constitute a contract with both banks.[46]

(4) *Direct export letter of credit* and *advice of credit opened.*[47] This letter is so called because it is issued by a bank in the seller's country, the drawee bank, at the request of a bank in the buyer's country, the issuing bank, in order to aid the exportation of merchandise, and authorizes the seller to draw directly upon itself. It is used in connection with the indirect import letter of credit.

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[40] See WHITAKER, p. 169.

[41] Gelpcke *v.* Quentell, 74 N. Y. 599 (1878); Ulster Bank *v.* Synnott, I. R. 5 Eq. 595 (1871).

[42] Johannessen *v.* Munroe, 158 N. Y. 641, 53 N. E. 535 (1899); Bank of Montreal *v.* Recknagel, 109 N. Y. 482, 17 N. E. 217 (1888); Maitland *v.* Chartered Bank, 38 L. J. Ch. 363 (1869).

[43] Vaughan *v.* Massachusetts Hide Corporation, 209 Fed. 667 (1913); Brazilian & Portuguese Bank *v.* British & American Exchange Banking Corporation, 18 L. T. R. 823 (1868); *In re* Agra Bank, *Ex parte* Tondeur, L. R. 5 Eq. 160 (1867); Russell *v.* Wiggin, 2 Story, 213 (1842); Carnegie *v.* Morrison, 2 Metc. (Mass.) 381 (1841).

[44] Lamborn *v.* Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N. Y. Supp. 162 (1821); Lafargue *v.* Harrison, 70 Cal. 380, 11 Pac. 636 (1886); Brazilian & Portuguese Bank *v.* British & American Banking Corporation, 18 L. T. R. 823 (1868).

[45] Vaughan *v.* Massachusetts Hide Corporation, 209 Fed. 667 (1913); Carnegie *v.* Morrison, 2 Metc. (Mass.) 381 (1841).

[46] Russell *v.* Wiggin, 2 Story, 213 (1842).

[47] Gelpcke *v.* Quentell, 74 N.Y. 599 (1878).

The seller frequently desires some authorization from the drawee bank in addition to and in confirmation of the authority which he has received from the issuing bank. Upon receipt of information that the issuing bank has issued its indirect import letter of credit the drawee bank may do one of six things: it may decline to issue any letter, it may issue its own direct revocable letter,[48] it may issue its letter of instruction,[49] it may issue its advice of credit opened unconfirmed,[50] it may issue its own direct irrevocable letter,[51] or it may issue its advice of credit opened confirmed.[52]

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[48] The form is the same as the direct import letter of credit. See WOLFE, pp. 421, 423.

[49] This is sometimes called a *banker's permission to draw*. See HOUGH, p. 546.

[50] See YORK, p. 137. The form varies among bankers.

FORM OF ADVICE OF CREDIT OPENED UNCONFIRMED.

"To . . . [name of the seller] . . .

DEAR SIR: Our correspondent, mentioned below, has authorized us as per their . . . dated . . . to pay you . . . for account of . . . [Buyer] . . . amount . . , against delivery of draft . . . document required. . . . All documents must be in form satisfactory to us and to represent and cover the following merchandise. . . . Our correspondent states that this authorization to us expires on . . . unless previously cancelled. Above credit opened by . . . [Issuing Bank] . . . This is an unconfirmed [or revocable] credit. It is not to be regarded as an agreement on our part, and is therefore subject to modification or revocation at any time.

Respectfully yours,

(Signed) . . . [Drawee Bank] . . ."

[51] See YORK, p. 137; HOUGH, p. 546; WOLFE, p. 424. The form is the same as the direct irrevocable import letter of credit.

[52] The form varies among bankers. See YORK, p. 137; WHITAKER, p. 169; HOUGH, p. 278; U. S. DEPT. OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 132; SILVER, p. 301; PRECIADO, p. 279; SAVAY, p. 301.

FORM OF ADVICE OF CREDIT OPENED CONFIRMED.

"To . . . [name of the seller] . . .

DEAR SIR: We have been requested to open a credit in your favor under the terms and conditions stipulated below:

Opened by . . . [Issuing Bank] . . . Account . . . [Buyer] . . . available by draft . . . covering . . . Drafts drawn under this credit must be presented not later than. . . . Documents required . . . This is to be regarded as a confirmed credit.

Respectfully yours,

(Signed) . . . [Drawee Bank]. . . ."

The terms *revocable* and *irrevocable* are properly applicable to direct import letters of credit, indirect import letters of credit, direct export letters of credit, and seller's export letters of credit. The terms *unconfirmed* and *confirmed* are sometimes used interchangeably with the terms *revocable* and *irrevocable* but are properly applicable only to those letters of advice which the drawee bank issues at the request of the credit-opening bank. "Where the drawee bank and the bank which grants the credit are different institutions, there may arise what is called the 'confirmed credit' . . . A con-

It is customary, however, for the drawee bank to issue either an advice of credit opened unconfirmed, or an advice of credit opened confirmed, depending upon the circumstances of the case, or to issue no letter at all. It is unusual for the direct letter of credit to be employed in this connection.

The direct export letters of credit and the advices of credit opened may be issued without any previous issue of an indirect import letter of credit. When time is an important element the buyer may go to a bank in his own country, sign the necessary agreement, and provide for a *cable credit* to be opened in favor of the seller. The buyer's bank cables to the seller and to the drawee bank, or frequently only to the drawee bank, and instructs the drawee bank to issue a specified letter to the seller. The letters usually requested in connection with a cable credit are the irrevocable direct export letter of credit or the advice of credit opened confirmed.

Three banks are usually involved in the confirmed credit and the direct export letter of credit transaction. The bank with which the buyer arranges for the credit is the credit-opening bank. If it writes its own indirect import letter of credit, it is the issuing bank in respect to that letter. This bank will be referred to, for the sake of uniformity, simply as the issuing bank. The second bank is the drawee bank, and is also the issuing bank in respect to its direct export letter of credit or advice of credit opened. This bank will be referred to, for the sake of uniformity, simply as the drawee bank. The third bank is the purchasing bank, which may in a given case be eliminated from the transaction.

The credit in connection with which the indirect import letter of credit and the direct export letter of credit, or advice of credit opened, are used may be either the acceptance credit, which is the normal letter of credit transaction, or the cash credit.[53]

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firmed credit is regarded as an exceptionally secure basis for the manufacture or collection of goods for export. If the agreement of sale between the merchants calls for a confirmed credit, the importer will ask his bank for the same and pay an extra commission. This bank will then advise the drawee (or London) bank to issue the confirmation and will pay it its commission for this action. In the majority of cases confirmation of the letters of credit of our bankers upon foreign institutions is not demanded. It is obvious that where a bank issues a letter of credit authorizing drafts on itself there is no point to a separate confirmation." — WHITAKER, FOREIGN EXCHANGE, pp. 169, 171 (1919).

[53] See Morgan *v.* Larivière, L. R. 7 H. L. 423 (1875).

The revocable direct export letter of credit and the advice of credit opened unconfirmed are understood in the business world to create no obligations from the time of issue.[54] They are subject to revocation in the same manner as the revocable import letters of credit. But they are in use to a much greater extent. The parties know that normally as a matter of banking business the drafts will be accepted and paid. But the banks do not, for a variety of business reasons, wish to enter into binding obligations at the time of issue. Exporters, however, are willing to rely on the normal course of business. The irrevocable direct export letter of credit and the advice of credit opened confirmed are considered as creating binding obligations from the moment of issue.[55]

The course of transaction which takes place under the indirect import letters of credit and the direct export letters of credit is practically the same as that which takes place under the direct import letter of credit. The seller presents the draft on the drawee bank with documents attached to his local bank for discount. At the same time he produces the letter of credit. The purchasing bank makes the necessary notations, detaches the shipping documents, and sends them directly to the issuing bank and the draft to the drawee bank. The drawee bank accepts the draft and charges the account of the issuing bank. The issuing bank surrenders, on an arrangement satisfactory to it, the bills of lading to the buyer, who resells the goods. The buyer then pays the amount due to the issuing bank, which remits to the drawee bank in time for it to meet its acceptance.

(5) *Seller's export letter of credit.*[56] This letter is procured by the seller and is usually of the indirect type. Suppose the seller is in New York and the buyer is in some place where banking facilities are poor and consequently it is impracticable for the buyer to procure a letter of credit. The seller goes to his New York bank and signs an agreement to reimburse similar in every respect to the

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[54] See U. S. DEPT. OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 132; PRECIADO, p. 279.

[55] See U. S. DEPT. OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 132; PRECIADO, p. 278; MARGRAFF, p. 89.

[56] See HOUGH, pp. 594–596; U. S. DEPT. OF COMMERCE, FOREIGN CREDITS, p. 54; ESCHER, FOREIGN EXCHANGE EXPLAINED, p. 139. See also Germania National Bank *v.* Taaks, 101 N. Y. 442, 5 N. E. 76 (1886); Union Bank of Canada *v.* Cole, 47 L. J. Q. B. 100 (1877); Carrollton Bank *v.* Tayleur, 16 La. 490 (1840).

agreement which the buyer signs in connection with the other forms of letters of credit. At the same time he gives the issuing bank a draft on the buyer, with the shipping documents attached, which is forwarded for collection. The seller is given a letter of credit which authorizes him to draw on another bank, usually a London bank.[57] This method combines the trade acceptance with the letter of credit. The seller's export letter of credit is usually a clean acceptance letter of credit.

The business transaction, in connection with which letters of credit are used, presents, therefore, many material variations which have real significance in the understanding and intention of the parties. When a specific case involving a letter of credit comes before a court the correct business analysis is an essential prerequisite to the legal determination. There is no magic in the term *letter of credit;* it is no nice formula which may be applied without discrimination. Any attempt to make it one can result only in confusion.

Commercial letters of credit raise many legal questions: which letters, if any, create legal rights and obligations from the time of issue? if they create legal rights and obligations from the time of issue, upon what theory must the conclusion be based? if they do not create legal rights and obligations from the time of issue, may legal rights subsequently arise and, if so, how? what is the relation of the sales contract to the letter of credit? what is the effect of fraud on the part of the buyer in procuring the letter or of the seller in using it? what is the effect of supervening insolvency of the buyer or of the bank? is there a suretyship element in the letter of credit transaction? are the letters negotiable or assignable? It is the purpose of this article to discuss these legal questions which are raised by commercial letters of credit, particularly those letters which have been classified under Type 3.

The confusion in the subject of letters of credit is due to a failure consciously to perceive and keep in mind that they have two dis-

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[57] The following variations of letters of credit in general may be noted:

Marginal Letters of Credit. The letter of credit is written in the margin of the draft. See Maitland *v.* Chartered Bank, 38 L. J. Ch. 363 (1869).

Revolving Letters of Credit. The letter of credit is automatically renewed when the buyer puts the bank in funds. See WOLFE, p. 415; Chartered Bank *v.* Macfayden, 64 L. J. Q. B. 367 (1895).

tinct aspects: (1) an authority to one person to draw drafts; and (2) a promise to another person that if he purchases the drafts they will be honored. In other words, there is one person, known as the accredited party, to whom credit is to be furnished, and another person, known as the accrediting party, who is to furnish the credit. Some letters, such as those used in connection with the cash credit, and some used in connection with the acceptance credit, direct attention exclusively to one aspect. But the modern commercial acceptance letter of credit contains both. The direct letter of credit, for example, contains two promises, one from the issuing bank to the seller, and the other from the issuing bank to purchasers of drafts. The indirect letter may contain an additional promise to the drawee bank. Most of the cases have arisen under the second aspect, where the problems are comparatively simple, and as a result the legal vocabulary of letters of credit is framed wholly in reference to that aspect. The more difficult questions, however, arise under the first aspect. And we shall therefore examine first the nature of the authority which is conferred by a letter of credit in order to determine the rights of the seller, as the accredited party, against the issuing and drawee banks.

II

RIGHTS OF THE SELLER AGAINST THE ISSUING AND DRAWEE BANKS

1. Is the Letter of Credit to be Recognized as a Mercantile Specialty which Requires no Consideration?

In countries which have the civil law, commercial letters of credit do not present a particularly difficult problem. No consideration is necessary to support a business promise.[58] But it is a fundamental principle of the common law that a promise not under seal in order to be binding must be supported by consideration.[59] The promisor may solemnly declare that his promise shall be irrevocable, and yet, if no consideration has been given for it, it is at best nothing more than a continuing offer which may be revoked before it has been accepted. The first problem in reference

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[58] For a discussion of letters of credit in continental law see Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1, 4–9 (1918).

[59] See 1 WILLISTON, CONTRACTS, §§ 107, 108, 109 (1920).

to the seller which letters of credit present is therefore the problem of consideration. It is the most important problem, because upon its solution the solution of all the other problems connected with these letters depends.

It may be urged with force from a business point of view that commercial letters of credit should be legally recognized as mercantile specialties which require no consideration.[60] Bankers, it may be argued, regard certain types of these letters as creating binding obligations; sellers in whose behalf they are issued rely upon them; the law should give its sanction to the business principle that a man's deliberate promise made in the course of business should be as good as his bond. To this it may be answered that customs of merchants should be given effect wherever possible, but wherever possible the effect should be given according to the principles of existing law.

Three objections may be made to the recognition of letters of credit as self-sufficing instruments of the law merchant. In the first place, these letters have not reached that point of uniformity that bills of exchange and promissory notes have attained.[61] There are many types, some of which are considered in the business world as creating binding obligations upon issue, and others of which are looked upon as revocable at will. If business ideas on the subject are not uniform, judicial ideas are chaotic. Moreover, letters of credit vary in formality from telegraphic communications and simple memoranda to letters written in ordinary epistolary form. There is considerable variation in the forms and in the transaction which gives rise to the letter. For an instrument to be a specialty it must have reached a high degree of formality. In the

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[60] See Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1 (1918). For cases which have a bearing upon the specialty aspects of letters of credit see British Linen Co. *v.* Caledonian Insurance Co., 4 Macq. 107 (1861); Waterston *v.* Edinburgh & Glasgow Bank, 20 Ct. Sess. 642 (1858); Orr & Barber *v.* Union Bank of Scotland, 1 Macq. 513 (1854).

This is unquestionably the desirable solution for the irrevocable and confirmed types of letters of credit. It is a significant commentary on the inadequacy of the common law to deal with simple business problems that it is extremely difficult for the rights of the seller to be worked out under the prevailing doctrine of consideration; so much so that it may be said to be still doubtful whether the seller acquires any rights at the time of issue.

[61] See J. F. Beal, "Utility of Letters of Credit in Export Trade — A Plea for Standard Forms," 95 BANKERS' MAGAZINE, 271 (N. Y., 1917).

second place, even if a letter of credit be recognized as a mercantile specialty, it does not follow that consideration is unnecessary. The trend of the common law has been to give effect to the custom of merchants which makes certain *choses in action* negotiable, but not to give effect to the custom of merchants which makes specialty promises binding without consideration. There is an essential difference between recognizing, in furtherance of commerce, that certain *choses in action* are assignable so as to confer upon the assignee original in distinction to derivative rights, and in recognizing that certain promises need no consideration to be legally enforceable. In the one case the question relates to the transferability of an existing legal right; in the other case the question concerns the creation of that right. To some extent, to be sure, especially in the matter of negotiable instruments, the common law has expanded and modified its strict conception of what constitutes consideration. But the law has never abolished its necessity. There was a time when consideration was thought to be a matter of evidence rather than a requirement of substantive law. Lord Mansfield in *Pillans* v. *Van Mierop*,[62] confusing in a strange way consideration with the Statute of Frauds, tried to abolish the requirement of consideration, in so far as written commercial promises were concerned, on the theory that the writing is sufficient proof of the existence of the contract. He was soon overruled, and this conspicuous failure of a great judge has been a warning to all later judges. The conception that the doctrine of *nudum pactum* does not apply to mercantile contracts is entirely exploded,[63] and it is now settled that even for negotiable instruments consideration is required as between the immediate parties.[64] In the third place, the tendency, legislative as well as judicial, is toward consideration and not away from it. The efficacy of seals has been almost everywhere abolished. At the same time there is a legislative tendency, evidential and procedural, not substantive, to give *prima facie* effect to any promise in writing.

The doctrine of consideration is due to accidents of history; it is peculiar to the common law; it may be thought of as pro-

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[62] 3 Burr. 1663 (1765).

[63] See Bank of Ireland *v.* Archer and Daly, 11 M. & W. 383, 389 (1843).

[64] See Holliday *v.* Atkinson, 5 B. & C. 501 (1826). See also 1 WILLISTON, CONTRACTS, § 108 (1920).

vincial; it may not be desirable; but it exists as a firmly established principle of English and American law. Courts might well modify the common-law conception of what constitutes consideration. This would be legitimate judicial extension of and deduction from established principle. But to abolish it is surely not within the province of the courts. In the past, no court has decided that a letter of credit needs no consideration. In the future, courts may treat these letters as mercantile specialties. But the opinion may be ventured that no court will, without legislative enactment, openly and consciously declare that they need no consideration for their support. The legal analysis of letters of credit must therefore be made according to common-law principles, but it is submitted that, once the correct business analysis is made in the particular case, the common law is adequate to deal with them.

2. *Is the Letter of Credit an Offer from the Issuing and Drawee Banks to the Seller for a Unilateral Contract?*

Some letters of credit constitute offers to the seller. A letter which requests S to sell goods to B and promises that the writer will pay,[65] or be responsible,[66] or be security for payment,[67] or pay if B does not pay,[68] is an offer. So, too, if the buyer furnishes the consideration to the issuing bank in the form of an executory promise to put the bank in funds on a specified date in return for a letter of credit which authorizes the buyer to draw on the issuing bank or on the drawee bank in favor of a named seller, or in favor of no specified person,[69] the letter is an offer to the designated

[65] Krakauer *v.* Chapman, 16 App. Div. 115, 45 N. Y. Supp. 127 (1897); Cheever *v.* Schall, 87 Hun, 32, 33 N. Y. Supp. 751 (1895); North Atchison Bank *v.* Garretson, 51 Fed. 168 (1892); Smith *v.* Montgomery, 3 Tex. 199 (1848); Lienow *v.* Pitcairn, Fed. Cas. No. 8,341 (1832); Edmonston *v.* Drake, 5 Pet. (U. S.) 624 (1831); Grant *v.* Naylor, 4 Cranch (U. S.) 224 (1808).

[66] Fletcher Guano Co. *v.* Burnside, 142 Ga. 803, 83 S. E. 935 (1914); Taylor *v.* Wetmore, 10 Ohio, 490 (1841); Walsh and Beekman *v.* Bailie, 10 Johns. (N. Y.) 180 (1813).

[67] Adams *v.* Jones, 12 Pet. (U. S.) 207 (1838); Robbins *v.* Bingham, 4 Johns. (N. Y.) 476 (1809).

[68] Holmes *v.* Schwab & Sons, 141 Ga. 44, 80 S. E. 313 (1913); London & San Francisco Bank *v.* Parrott, 125 Cal. 472, 58 Pac. 164 (1899); Crane Co. *v.* Specht, 39 Neb. 123, 57 N. W. 1015 (1894); Johnson *v.* Brown, 51 Ga. 498 (1874); Douglass *v.* Reynolds, 7 Pet. (U. S.) 113 (1833); Sollee *v.* Meugy, 1 Bailey Law (S. C.) 620 (1830).

[69] Nelson *v.* First National Bank of Chicago, 48 Ill. 36 (1868); Lawrason *v.* Mason, 3 Cranch (U. S.) 492 (1806).

seller, or to any one if no specified seller is named, that, if the drafts are taken according to the terms of the letter, the issuing bank, if the letter is of the direct type, or the drawee bank, if it is of the indirect type, will accept and pay them at maturity.[70] The buyer's agreement with the issuing bank plus the letter of credit constitutes a bilateral contract between the bank and the buyer. But the letter of credit is no less an offer to the seller. The same instrument may be a contract with one person and an offer to another.

The authority to draw [71] and the authority to purchase drafts [72] are also offers. When the buyer delivers to the issuing bank his authority to draw he requests the issuing bank to issue to the purchasing bank its authority to purchase, and it is further contemplated that the purchasing bank will issue its letter of advice to the seller. The offer of the buyer to the issuing bank consequently is not simply that, if the issuing bank purchases a specified draft drawn by the seller on the buyer, the buyer will honor it, but that the buyer will honor it if the issuing bank comes under legal liability as a result of the contemplated transaction.[73] The authority to draw used in conjunction with the authority to purchase and with the letter of advice may comprise three dependent offers: one from the buyer to the issuing bank; a second from the issuing bank to the purchasing bank; a third from the purchasing bank to the seller. When the seller presents to the purchasing bank for discount the draft on the buyer all three offers are accepted simultaneously. The purchasing bank comes under a contract

[70] In such a case the seller is in the position of the accrediting party. This is the usual type of the traveler's letter of credit. See WHITAKER, pp. 181–189; BROOKS, pp. 139–141.

[71] Wilson & Co. *v.* Niffenegger, 211 Mich. 311, 178 N. W. 667 (1920); Lyon *v.* Van Raden, 126 Mich. 259, 85 N. W. 727 (1901); Hall *v.* First National Bank, 133 Ill. 234, 24 N. E. 546 (1890); Johnson *v.* Blakemore, 28 La. Ann. 140 (1876); Michigan State Bank *v.* Estate of Leavenworth, 28 Vt. 209 (1855); Union Bank of Louisiana *v.* Coster, 3 N. Y. 203 (1850).

[72] Sigel-Campion Live Stock Commission Co. *v.* Davis, 69 Colo. 511, 194 Pac. 468 (1921); Bank of Plant City *v.* Canal-Commercial Trust & Savings Bank, 270 Fed. 477 (1921); Lemon Importing Co. *v.* Garfield Savings Bank, 187 App. Div. 932, 173 N. Y. Supp. 551 (1919); Borthwick *v.* Bank of New Zealand, 17 T. L. R. 2 (1900); Second National Bank *v.* Diefendorf, 90 Ill. 396 (1878); White's Bank of Buffalo *v.* Myles, 73 N. Y. 335 (1878); Omaha National Bank *v.* First National Bank, 59 Ill. 428 (1871); Waterston *v.* Edinburgh & Glasgow Bank, 20 Ct. Sess. 642 (1858).

[73] Borthwick *v.* Bank of New Zealand, 17 T. L. R. 2 (1900).

liability, its liability is an acceptance of the issuing bank's offer, and the issuing bank's ensuing liability is an acceptance of the buyer's offer. Consequently it may be stated that an authority to draw and an authority to purchase cannot be revoked or modified after the draft has been presented by the seller for its first contemplated negotiation.[74]

Similarly, the direct import letter of credit, if issued in the revocable form, is an offer.[75] The buyer's agreement, although said to be made in consideration of the issue of the revocable letter of credit, is nothing more than an offer. But since it contemplates an offer to be made in turn by the issuing bank to the seller, it is an offer which is accepted when the issuing bank comes under a legal obligation as the result of the issue of its revocable letter of credit. This revocable letter of credit contains two offers: one an express offer to the seller; and the other either an express or an implied offer to purchasers of the drafts. Consequently, the offer of the issuing bank is accepted when the seller first negotiates the draft or when he presents it for acceptance.[76] At that moment there also comes into existence a contract between the buyer and the issuing bank.[77]

In the same manner the indirect import letter of credit, if issued in the revocable form, may be analyzed as an offer. The buyer's agreement is a preliminary offer. The letter of credit itself contains three offers: one from the issuing bank to the seller; a second from the issuing bank to purchasers of drafts; a third from the issuing bank to the drawee bank. And if the drawee bank issues its own revocable direct export letter of credit, or its letter of advice, or its advice of credit opened unconfirmed, these are also offers to the seller and to purchasers of the drafts. Upon presentation of the specified drafts by the seller to the drawee bank or upon first negotiation, three unilateral contracts come into existence simultaneously. Hence at that time these revocable letters become irrevocable in respect to that particular transaction.

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74 See Gelpcke *v.* Quentell, 74 N. Y. 599 (1878).

75 See De Tastett *v.* Crousillat, Fed. Cas. No. 3,828 (1807). See also *infra*, note 158.

76 Gelpcke *v.* Quentell, 74 N. Y. 599 (1878); Ilsley *v.* Jones, 12 Gray (Mass.) 260 (1858).

77 Lienow *v.* Pitcairn, Fed. Cas. No. 8,341 (1832).

If more than one draft is contemplated these letters constitute a series of continuing offers which may be revoked as to future transactions.

This analysis of these types of letters of credit conforms to the intention of the parties. The seller may improperly perform the sales contract, business conditions may change, the buyer may become insolvent, or he may have procured the letter fraudulently. If any of these events have happened the offer has only to be revoked. The offer theory, therefore, when applied to these letters is not only sound but it is adequate. The only risk is that revocation may not be made in time.

But the direct import letter of credit, the indirect import letter of credit, and the direct export letter of credit, if issued in the irrevocable form, and the advice of credit opened confirmed, cannot be analyzed as offers to the seller without doing violence to facts. If the letter is an offer from the bank to the seller for a unilateral contract what is the act which is consideration for the bank's promise? It is not the making of the sales contract:[78] first, because banks are not in the business of bargaining for sales contracts to be made; and secondly, because the sales contract is usually already made before the letter of credit is issued. It is not the manufacture or the starting manufacture by the seller: first, because this is not what the bank is bargaining for; and secondly, because performance by the seller of an act which he is already legally bound to perform cannot be consideration for the bank's promise.[79] If the letter of credit is an offer it is an offer to accept a draft with specified shipping documents attached. Hence there is an interval between the issue of the letter of credit and the presentation of the drafts during which the bank could revoke its offer with legal impunity to itself and with possibly dire results to the seller. If the buyer were discovered to have been fraudulent, or if he became insolvent, the issuing bank could at once revoke the unaccepted offer. But the very purpose of the letter of credit is to guard against such possibilities. The contemplation of the parties is that these letters constitute irrevocable and binding obligations upon the issuing and drawee banks in favor of the seller from the moment they are issued. The offer theory nullifies this intention.

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[78] See Edmonston *v.* Drake, 5 Pet. (U. S.) 624 (1831).

[79] But see Bell *v.* Moss, 5 Whart. (Pa.) 189 (1840).

It is at this point that the danger of definition becomes acute. Early types of letters of credit were requests to the seller for sales to be made. The modern type of irrevocable letter of credit contains two promises: one to the seller, and the other to purchasers of drafts. The promise to purchasers of drafts, as will subsequently appear, is an offer. Hence it is not surprising to find the orthodox judicial definition of a letter of credit ignoring the nature of the authority conferred upon the seller and directed either to the request for the sale of goods or to the request for the furnishing of money, and therefore phrased in the language of request and offer.[80] There is danger that courts, having defined letters of credit in terms of one characteristic, will apply the definition indiscriminately to the other and wholly different characteristic. In a few instances this has happened.[81] The great weight of judicial decision, however, is against the theory that irrevocable and confirmed types of letters of credit constitute offers to the seller.

3. Does the Letter of Credit Constitute a Bilateral Contract between the Issuing and Drawee Banks and the Seller with Consideration Moving from the Seller as Promisee?

The seller's irrevocable export letter of credit taken together with the seller's agreement to reimburse constitutes a bilateral contract between the issuing bank and the seller. Consideration moves from the seller as promisee to the issuing bank as promisor. Consequently this type of letter presents no difficulties. Whatever rights the seller has against the drawee bank depend upon principles of agency.[82]

But letters of credit procured by the buyer do not constitute bilateral contracts between issuing bank and seller with consideration moving from the seller as promisee. Since an offer for a unilateral contract affords the offeree no protection after he has started, but before he has completed, performance, courts will, if possible, always construe an offer as an offer for a bilateral con-

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[80] See *supra*, note 2.

[81] See Lafa gue *v.* Harrison, 70 Cal. 380, 11 Pac. 636 (1886).

[82] See Carrollton Bank *v.* Tayleur, 16 La. 490 (1840). See also *supra*, note 56. Where the letter is written by the buyer the sales contract would be sufficient to support the seller's authority to draw.

tract.[83] The irrevocable letter of credit is not an offer to the seller. But if it is an offer it is so clearly an offer for a unilateral contract that it would be almost impossible to give it any other construction. If the sales contract is not made until after the seller receives the letter of credit, the seller's promise to the buyer, if requested by the issuing bank, would be sufficient consideration for the bank's promise to the seller. The fatal objection is that the making of the sales contract is not what is requested by the bank in return for its letter of credit. There is therefore no consideration in fact. If the sales contract has already been made, as is usually the situation, the seller would be promising to perform what he was already under a legal duty to perform. There would be no consideration in law. Moreover, if the irrevocable indirect import letter of credit constitutes a bilateral contract between issuing bank and seller for which the seller furnishes the consideration, there is a further difficulty in working out contract rights of the seller, against the drawee bank in those cases where the relation of principal and agent does not exist between the two banks. The direct letter which the drawee bank issues to confirm the indirect letter cannot be held to be a bilateral contract with the seller, for which the seller furnishes the consideration, because the seller is already legally bound to the issuing bank to perform the same act. Unless, therefore, a novation is worked out between the seller and the two banks, or, unless a solution is to be found in ratification, the irrevocable direct export letter of credit of the drawee bank or the advice of credit opened confirmed would create no legal obligation on the part of the drawee bank. A novation would be contrary to their intentions. A solution might be found in ratification.

In the case of the direct import letter of credit, what the parties have in mind is a contract with the buyer, the seller, and the issuing banks as parties, the consideration for the buyer's promise to the bank being the bank's promise to the seller, and the consideration for the bank's promise to the seller being the buyer's promise to the bank to put it in funds on a specified day plus payment of a commission. In the case of the indirect letter of credit the parties have the same thing in mind. If the relation of principal and agent

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[83] For an extreme case see Los Angeles Traction Co. *v.* Wilshere, 135 Cal. 654, 67 Pac. 1086 (1902).

exists between the two banks, it is further contemplated that the drawee bank shall also be bound to the seller, but if no such relation exists, then the irrevocable direct export letter of credit or advice of credit opened confirmed shall constitute another contract between the drawee bank and the seller with the consideration moving from the issuing bank to the drawee bank, or else a ratification of a contract made on behalf of the drawee bank.

The question is whether such contracts can confer rights upon the seller. To answer this question fully, it will be necessary to examine three methods of solution: (1) contract between the buyer and the issuing bank for the benefit of the seller; (2) contract between the bank and the seller with consideration moving to the bank from the buyer; (3) contract between the buyer and the bank with a simultaneous assignment by the buyer to the seller.

4. *Is the Letter of Credit a Bilateral Contract between the Issuing and Drawee Banks and the Buyer for the Benefit of the Seller?*

In *Carnegie* v. *Morrison* [84] one Bradford, the buyer, in consideration of the issue of a letter of credit, promised to cover the drafts at maturity. The issuing bank, acting as agent for the drawee bank, gave the buyer the following letter:

"Boston, 4 March, 1837.

"Messrs. MORRISON, CRYDER & Co., [Drawee Bank]
London.

"Mr. John Bradford [Buyer] of this city having requested that a credit may be opened with you for his account in favor of Messrs. D. Carnegie & Co. [seller] of Gothenburg for three thousand pounds sterling, I have assured him that the same will be accorded by you on the usual terms and conditions.

Respectfully your obt. serv't.
FRANCIS J. OLIVER [Issuing Bank]

"For £3000"

This letter was delivered to the buyer, who sent it to the seller. Shortly afterwards the drawee bank wrote the seller that the credit could not be granted. Nevertheless, the seller drew the bill of exchange on Morrison, Cryder & Co. and, acceptance having been refused, brought an action against the drawee bank. It was held that the seller could maintain the action in his own name. It is

[84] 2 Metc. (Mass.) 381 (1841).

not certain upon what ground the court based its decision, although the general tenor of the opinion seems to be that the seller was the beneficiary of a contract made between the drawee bank and the buyer.

Carnegie v. *Morrison* [85] is the only case which approaches the view that a letter of credit is a contract between the buyer and the bank for the benefit of the seller. It will be noted that the letter in that case was a peculiar one, of a type not now in ordinary use. When the letter is procured by the buyer and is addressed to the drawee bank, or when it is addressed to the buyer and authorizes the seller to draw on the issuing or drawee banks, there is basis for construing the transaction as a contract between the buyer and the banks for the benefit of the seller. The essential inquiry, however, is not who procures the letter or to whom it is addressed or to whom it is delivered, but to whom the promise is made. The intention of the parties usually is that the bank shall make a direct promise to the seller. This feature prevents the transaction from being a contract for the benefit of a third person.

Indeed, to construe the letter of credit as a contract for the benefit of the seller would not only ignore the intention of the parties but would be unfortunate in its business results. In England [86] and in some American states the seller as beneficiary could maintain no action against the issuing or drawee banks. Even in jurisdictions where he can maintain an action at law in his own name his rights are derivative, and consequently he would take the benefits of the contract subject to all defenses which the issuing and drawee banks had against the buyer.[87] Thus fraud in the inception, supervening fraud, failure of consideration, insolvency of the buyer, would all be defenses available to the banks. Both from the seller's and from the buyer's point of view this result would destroy the value and usefulness of the irrevocable letter of credit.

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[85] 2 Metc. (Mass.) 381 (1841).

[86] Dunlop Pneumatic Tyre Co. *v.* Selfridge & Co., [1915] A. C. 847.

[87] Jenness *v.* Simpson, 84 Vt. 127, 139, 143, 78 Atl. 886 (1911); Green *v.* Turner, 86 Fed. 837 (1898); Clay *v.* Woodrum, 45 Kan. 116, 25 Pac. 619 (1891); Maxfield *v.* Schwartz, 45 Minn. 150, 47 N. W. 448 (1890); Amonett *v.* Montague, 75 Mo. 43 (1881); Benedict *v.* Hunt, 32 Iowa, 27 (1871); See also 1 WILLISTON, CONTRACTS, § 394 (1920).

5. *Is the Letter of Credit a Contract between the Issuing and Drawee Banks as Promisors and the Seller as Promisee with Consideration Moving from One Other than the Promisee?*

When the direct import letter of credit is issued in the irrevocable form the parties have in mind a contract whereby the buyer promises the issuing bank to put it in funds at a future date and to pay a specified commission in return for the promise of the issuing bank made directly to the seller on certain conditions precedent. When the indirect import letter of credit is issued in the irrevocable form the same result is in the minds of the parties. If no relation of principal and agent exists between the drawee and issuing banks, the parties contemplate that the buyer is furnishing the consideration, in the form of an executory promise to the issuing bank, and frequently in the form of a cash payment of the commission, in return for the promise of the issuing bank made directly to the seller that the drawee bank will accept and pay drafts of the seller drawn upon it. The letter is also an offer to the drawee bank from the issuing bank. When the drawee bank accepts the draft a unilateral contract is formed between the two banks, and when the drawee bank pays the draft the contract of the issuing bank with the seller is discharged. If a confirmed credit is requested and the drawee bank issues its own direct export letter of credit in the irrevocable form, or its advice of credit opened confirmed, there are two contracts in existence: one contract between the buyer, issuing bank, and seller with the consideration moving from the buyer to the issuing bank for its promise made directly to the seller; the other a contract between the issuing bank, drawee bank, and seller with the consideration moving from the issuing bank to the drawee bank for its promise made directly to the seller. Or the confirmed letter may amount to a ratification of the previous contract. If the relation of principal and agent exists between the drawee bank as principal and the issuing bank as agent, then the indirect import letter of credit is intended to confer immediate contract rights upon the seller against the drawee bank, and upon its failure to accept and pay, against the issuing bank. If a direct irrevocable export letter of credit or an advice of credit opened confirmed is requested and issued by the drawee bank, this is simply a confirmation of the agency, and the giving to the seller of an

instrument which he can use in negotiating his drafts to better advantage than the letter of the issuing bank.

If the sales contract is made before the letter of credit is issued, then, if the irrevocable direct or indirect import letter is sent by the bank to the seller the contract is complete with the seller on mailing. If the letter of credit is given to the buyer for the purpose of being sent by the buyer to the seller the contract is formed when the letter is issued and delivered to the buyer.[88] The seller in either case has assented in advance. If the irrevocable letter of credit is issued before the sales contract is made, which would be a rare situation, the seller acquires a contract right subject to disaffirmance.

This being the contemplation of the parties, can legal effect be given to it? If A makes a promise to B in exchange for B's promise made not to A but to C, or made both to A and C, can C maintain an action on the contract as promisee against B as promisor?

Historically, consideration is bound up in the tort of deceit. Hence it is that while many courts define consideration as detriment to the promisee or benefit to the promisor, most courts in practice insist upon detriment to the promisee as the sole test. There are three conceivable conceptions of consideration: benefit to the promisor with no detriment to any one; detriment to the promisee; detriment to one other than the promisee given as benefit to the promisor. In the case of the letter of credit it is not necessary to go to the extent of saying that benefit alone to the promisor is sufficient consideration. It is only necessary to broaden and modify the common-law conception of consideration to include detriment to one other than the promisee. The law has been constantly broadening its conception of consideration. It is settled that consideration need not move to the promisor. Consideration moving from the promisee to a third person at the request of the promisor is sufficient to support the contract. Certainly this is

[88] Compare Union Bank of Canada *v.* Cole, 47 L. J. Q. B. 100 (C. A. 1877).

In Carnegie *v.* Morrison, 2 Metc. (Mass.) 381 (1841) the letter of credit was written and delivered to the buyer in Boston, authorizing the seller to draw on a London bank. The buyer sent the letter to the seller in Sweden. In an action in Massachusetts by the seller against the drawee bank for cancelling the credit it was held that the contract was made in Boston and that Massachusetts law governed.

See Sovereign Bank of Canada *v.* Bellhouse, Dillon & Co., 23 Q. R. (K. B.) 413 (1914).

so in unilateral contracts. And it would seem that consideration moving to the promisor from a third person on behalf of the promisee is sufficient consideration to support the contract in favor of the promisee. Upon performance it would give the promisor a right against the third person, for as to that person the promisor is in the position of promisee giving consideration to a designated person at the request of the promisor. It is only necessary to extend this unilateral situation to the bilateral or trilateral situation to give all the parties rights on the contract. Such an extension of consideration would not be revolutionary, but would be a legitimate judicial development of existing principles. There is no reason in the nature of things why even in bilateral contracts consideration need move from the promisee. There is no reason why primitive ideas of consideration should remain immutable.[89]

This situation is quite different from the contract for the benefit of a third person. The reason why a beneficiary should not be able to sue is not that he is a volunteer. The reason is that he is not a party to the contract. In other words, the difficulty is not one of consideration. But in the contract where one other than the promisee furnishes the consideration there is no question but that the promisee is a party. The only question is one of consideration. The judges in *Lawrence* v. *Fox* [90] clearly perceived this distinction. The *ratio decidendi* of Judge Denio, allowing the beneficiary to recover, was that the beneficiary is a party to the contract as promisee. The other judges of the majority declined to base their decision on the proposition that the beneficiary was a promisee. The dissenting judges dissented solely on the ground that he was not a promisee.

In the United States the law seems to be settled that consideration need not move from the promisee. Since the time of *Lawrence* v. *Fox* [91] a long line of American cases have squarely decided that a promisee can enforce a contract where the consideration moves to the promisor from one other than the promisee.[92] This is the

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[89] See 1 WILLISTON, CONTRACTS, § 114 (1920).

[90] 20 N. Y. 268 (1859).

[91] 20 N. Y. 268 (1859).

[92] Bobrick *v.* Second National Bank of Hoboken, 175 App. Div. 550, 162 N. Y. Supp. 147, 115 N. E. 1034 (1916); Hamilton *v.* Hamilton, 127 App. Div. 871, 112 N. Y. Supp. 10 (1908); Bell *v.* Sappington, 111 Ga. 391, 36 S. E. 780 (1900); Palmer Savings Bank *v.* Insurance Co. of North America, 166 Mass. 189, 44 N. E. 211 (1896); Williamson

favorite Massachusetts device of construction for reaching the result of *Lawrence* v. *Fox*.[93]

The American cases which have examined the rights of the seller under the irrevocable letters of credit have almost always based their results on the theory that the letter of credit is a contract between the bank as promisor and the seller as promisee with consideration moving from one other than the promisee.

In *Carnegie* v. *Morrison*,[94] discussed previously in another connection, Phillips *arguendo* [95] insisted that there was a valid contract to which the seller was a party as promisee with consideration furnished by the buyer to the bank as promisor.

"Where a valid simple contract, as this is admitted to be, bears on its face, as this does, that it is made in favor of a party and in his behalf, on a sufficient consideration applicable to the contract, whencesoever that consideration may have come, and the party, in whose favor and behalf it is made, assents to, adopts and acts upon it, as the contract imports or requires, he is a party to that contract. There may be decisions to the contrary; but if there are, they are opposed to the general current of jurisprudence. How far we may go, by evidence *aliunde*, to show who the party interested is, we need not inquire; for we have here such party named in the contract.

"The same instrument may be, and often is, a contract by one person with divers others, who, if their interests and damage be joint, have a joint action; if separate, and so it appears by the contract, they have separate actions. The question is, what does the contracting party undertake to pay or do, and to whom, and for whose benefit? It is not material that a contract in an epistolary form should be addressed to the person with whom it is intended to be made. . . . Letters of credit are very frequently not so addressed."

It is not certain what the *ratio decidendi* of the court was. But there is language in the opinion of Chief Justice Shaw to the effect that the seller was a party to the contract.[96]

"The objection to such an action and the ground of this defence are, that the immediate parties to the transaction were Bradford [the buyer]

v. Yager, 91 Ky. 282, 15 S. W. 660 (1891); Rector of St. Mark's Church *v.* Teed, 120 N. Y. 583, 24 N. E. 1014 (1890); Van Eman *v.* Stanchfield, 10 Minn. 255 (1865); Cabot *v.* Haskins, 3 Pick. (Mass.) 83 (1825). See 1 WILLISTON, CONTRACTS, § 114 (1920).

[93] 20 N. Y. 268 (1859).

[94] 2 Metc. (Mass.) 381 (1841).

[95] 2 Metc. (Mass.) 381, 385–386 (1841).

[96] 2 Metc. (Mass.) 381, 396, 400 (1841).

on the one side, and the defendants [drawee bank] on the other; that to this transaction the plaintiffs [the seller] were strangers; and that as Bradford acquired some right under it, and had a remedy upon it against the defendants, their contract must be deemed to be made with him and not with the plaintiffs. But this position presupposes that the same instrument may not constitute a contract between the original parties, and also between one or both of them and others, who may subsequently assent to, and become interested in its execution; an assumption quite too broad and unlimited, which the law does not warrant. . . .

"Regarding it as a question of principle and not of technical law, it was an undertaking, in which the plaintiffs had an interest, nearly or quite as direct and as great, as if the promise had been in terms to them."

In *Johannessen* v. *Munroe*,[97] which will be discussed subsequently in another connection, the sole question before the court was whether there was a sufficient allegation in the seller's declaration that the buyer had furnished consideration.

In *Sovereign Bank of Canada* v. *Bellhouse, Dillon & Co.*,[98] the buyer, after having procured an irrevocable letter of credit in favor of the seller, instructed the bank to cancel it. In an action by the seller against the bank it was held that the letter could not be lawfully revoked. The court went on the ground that the contract is not between the bank and the buyer, but is between the bank and the seller. The headnote, which accurately expresses the opinion of the court, says:

"No rule of law prevents a person, furnishing consideration in favor of another person, from binding the latter with a third."

In *American Steel Company* v. *Irving National Bank*,[99] the court, quoting the case of *Sovereign Bank of Canada* v. *Bellhouse, Dillon & Co.*[100] with approval, based its decision on the proposition that a binding executory contract was formed between the bank and the seller as soon as the letter was issued.

"The liability of the bank on the letter of credit as agreed upon between plaintiff and defendant was absolute from the time it was

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[97] 84 Hun, 594, 32 N. Y. Supp. 863 (1895); 9 App. Div. 409, 41 N. Y. Supp. 586 (1896); 158 N. Y. 641, 53 N. E. 535 (1899).

[98] 23 Q. R. (K. B.) 413 (1914).

[99] 266 Fed. 41, 43, 44 (1920).

[100] 23 Q. R. (K. B.) 413 (1914).

issued. . . . The law is that a bank issuing a letter of credit like the one here involved cannot justify its refusal to honor its obligations by reason of the contract relations existing between the bank and its depositor. . . . There is but one vital question involved in this case. It is whether the letter of credit already set forth herein is a complete and independent contract between the plaintiff [seller] and the defendant [issuing bank]. This court is satisfied that it is. . . ."

Other recent American cases adopt the same analysis.[101]

On this theory, the buyer would also have a right of action against the bank if the bank expressly or impliedly makes a promise to the buyer. The consideration moving from the buyer would be sufficient to support a promise made by the bank to the buyer and a promise made by the bank to the seller.

If this analysis is adopted, namely, that the letter of credit is a contract between the issuing and drawee banks as promisors and the seller as promisee with consideration furnished by one other than the promisee, would supervening insolvency of the buyer or failure of consideration or fraud on the part of the buyer in procuring the letter of credit constitute defenses to the bank against the seller? It has been held that supervening insolvency of the buyer or failure of consideration constitute no defense to the bank against the seller.[102] No case has raised the question of fraud. But its effect, it would seem, should be controlled by the same principles. These principles must be deduced by analogy. No analogy can be drawn from the doctrine that an assignee of a simple *chose in action* is subject to the defenses to which his assignor was subject, for that doctrine is based on the fact that the assignee's rights are derivative, whereas in this situation the seller's rights are original. The doctrine that the beneficiary of a contract is subject to defenses existing between the contracting parties furnishes no aid if that doctrine is based on the argument that the beneficiary's rights are derivative. It would furnish a direct analogy if the doctrine is based on the fact that the beneficiary

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[101] See International Banking Corporation *v.* Irving National Bank, 274 Fed. 122 (1921); Frey & Son *v.* Sherburne Co. and the National City Bank, 193 App. Div. 849, 184 N. Y. Supp. 661 (1920). See also Duncan *v.* Edgerton, 19 N. Y. Super. Ct. (6 Bosw.) 36 (1860); Russell *v.* Wiggin, 2 Story, 213, 229, 230 (1842). For an interesting recent case involving interpleader see Bank of Taiwan *v.* Gorgas-Pierie Mfg. Co., 273 Fed. 660 (1921).

[102] See *infra* note 182.

is a donee. There are also other principles to be borne in mind. If one person is induced to make a contract with another by the fraud of a third, that fraud is no ground for avoiding the contract, unless the fraudulent person was agent for the promisee, or unless the promisee is a donee.[103] Unless, therefore, the seller is to be considered a donee of the letter of credit, or unless the buyer is agent for the seller in making the letter of credit contract, fraud of the buyer in the inception of the contract would constitute no defense to the bank against the seller. Whether the seller is donee or whether the buyer is agent for the seller are questions of extreme difficulty, and no aid in their solution is to be found in the decisions. The problem is as yet judicially unsolved. A suggestion may be ventured. The sales contract, under this analysis, is wholly independent of the letter of credit. And yet both transactions, in the contemplation of all the parties, are bound up together. This fact may be sufficient to prevent the seller from being a donee, although strictly in a legal sense he is probably a donee of the bank's promise. He is not a donee in a business sense. At any rate, after the seller receives the letter of credit and starts to manufacture the goods, since the fraud of the buyer constitutes a breach of that part of the sales contract which provides that a letter of credit shall be procured, so that the seller could sue the buyer or rescind the sale, the fraud of the buyer against the bank amounting to a fraud against the seller, the non-action of the seller against the buyer should be a sufficient change of position for the seller to be considered to have given value, on the same principle that a surrender of an antecedent debt is considered value.[104] Or, looked at in another way, the procuring of a letter of credit is a condition precedent of the seller's promise in the sales contract. The seller waives this condition upon receipt of the letter of credit, and this is value.

Under this explanation, although so far as consideration goes the letter of credit is irrevocable from the moment of issue, nevertheless revocation could be made for defenses at any time before the seller gave this value. In order to make the letter irrevocable

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[103] See Scholefield *v.* Templar, 4 De Gex & J. 429 (1859); See also 3 WILLISTON, CONTRACTS, § 1518 (1920).

[104] See London and County Banking Co. *v.* London and River Plate Bank, 21 Q. B. D. 535 (C. A. 1888).

for all purposes from the moment of issue a better explanation perhaps is that the commission covers the risks of fraud and insolvency of the buyer, and that as a matter of business expediency the risk should be borne legally by the bank. The parties contemplate this result. There is no reason why legal effect should not be given to their intention. Nor should the buyer be considered as agent for the seller in making the contract.[105] The bank has no affirmative right against the seller. For this purpose the buyer and the seller should be regarded as wholly independent of each other. From a business point of view it would be unfortunate to subject the seller to the fraud of the buyer. The purpose of the letter of credit is to put the buyer in a negligible position and to substitute for his responsibility the responsibility of a bank. It would seem that all defenses which the bank seeks to set up because of conduct of the buyer should be treated in the same way. Therefore, the cases which hold that insolvency of the buyer and failure of consideration are no defenses are authority for the proposition that fraud of the buyer is equally no defense. However it may be decided that the issuing bank may rescind, it is difficult to see upon what theory the drawee bank, in cases of indirect import and direct export letters of credit, could rescind where there is no agency between the two banks, and it has issued its own irrevocable letter.

In England, it is to be feared that the irrevocable letter of credit cannot be supported on the theory that it is a contract between the issuing and drawee banks and the seller with consideration moving from one other than the promisee. The English courts started with the doctrine that consideration must move from the promisee. Then came a series of cases in which it was decided that consideration need not move from the promisee.[106] But in 1915 the House of Lords in *Dunlop Pneumatic Tyre Co.* v. *Selfridge & Co.*[107] reverted to the original doctrine. As an alternate ground of decision it was laid down as fundamental that the promi-

[105] See *infra* notes 203, 205. For business reasons the risk of fraudulent conduct of the seller falls on the buyer. For business reasons the fraudulent conduct of the buyer should fall on the bank.

[106] See 1 WILLISTON, CONTRACTS, § 114 (1920). See also Thomas *v.* Thomas, 2 Q. B. 851 (1842). See Lilly *v.* Hays, 5 A. & E. 548 (1836).

[107] [1915] A. C. 847, 853.

see, even if he were an undisclosed principal, in order to maintain an action on the contract must have furnished the consideration. Lord Haldane in delivering his judgment was quite clear on this point.[108]

"My lords, in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. . . . A second principle is that if a person with whom a contract not under seal has been made is to be able to enforce it consideration must have been given by him to the promisor or to some other person at the promisor's request."

No allusion was made to the fairly long line of English cases which had held the contrary. But these cases must be regarded as overruled.

In England, therefore, the seller as promisee could have no contract right against the issuing and drawee banks on the analysis that the buyer furnished the consideration for the promise. There is some indication that the offer analysis might be applied.[109] There is clear indication that estoppel would not be applied.[110] A third possible analysis for the English courts is that the letter of credit is a bilateral contract between the buyer and the bank and a simultaneous assignment to the seller by the buyer with immediate notice to the bank.

6. *Is the Letter of Credit a Bilateral Contract between the Issuing and Drawee Banks and the Buyer and a Simultaneous Assignment by the Buyer to the Seller?*

All courts will agree that the irrevocable types of letters of credit create contracts with some one from the moment of issue. The disagreement comes in recognizing the seller's right under this contract. As between the buyer and the issuing bank the buyer's agreement is more than an offer to reimburse; it is more than an offer for a unilateral contract; the buyer bargains for a bilateral contract; he is interested not merely in performance but in the promise to perform; he bargains for a promise made directly to the

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108 [1915] A. C. 847, 853.

109 See *In re* Agra and Masterman's Bank, *Ex parte* Asiatic Banking Corporation, 2 Ch. App. 391 (1867).

110 Morgan *v.* Larivière, L. R. 7 H. L. 423 (1875). See *infra*, p. 586.

seller. There is in terms no express promise ordinarily made by the bank to the buyer, but it is not difficult to imply from the circumstances of the transaction that the bank promises the buyer to perform. Hence for default the buyer would have an action which he could not have if acceptance and payment of drafts by the bank were merely conditions of his promise. To find a bilateral contract between the buyer and the bank is easy. The essential thing, however, is not the bank's express or implied promise to the buyer, but the bank's written promise to the seller. It is this feature which puts the transaction into a category other than a contract for the benefit of a third person. It is only an adherence to the strict common-law conception of consideration that prevents legal effect from being given to the transaction as the parties contemplate it.

There is some indication in the English cases,[111] and in a few American cases,[112] that the direct and indirect types of irrevocable import letters of credit might be treated as contracts between the issuing and drawee banks and the buyer with an immediate assignment by the buyer to the seller. It strains the facts somewhat to follow this construction when the letter is addressed to the seller and sent directly to him by the bank. It is more plausible when the letter is addressed to the buyer authorizing the seller to draw, or when it is addressed to the seller but is delivered to the buyer and by him sent to the seller.

This theory is not wholly satisfactory. It confers upon the seller only equitable or derivative rights. Any defense which the bank might have against the buyer prior to notice of the assignment could be set up against the seller. Thus fraud in the inception would vitiate the transaction as against the seller.[113]

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[111] See Hindley & Co. *v.* Tothill, Watson & Co., 13 N. Z. L. R. 13 (C. A. 1894); Union Bank of Canada *v.* Cole, 47 L. J. Q. B. 100 (C. A. 1877); Prehn *v.* Royal Bank of Liverpool, L. R. 5 Ex. 92 (1870); *In re* Agra and Masterman's Bank, *Ex parte* Asiatic Banking Corporation, L. R. 2 Ch. App. 391 (1867); *In re* Agra Bank, *Ex parte* Tondeur, L. R. 5 Eq. 160 (1867).

[112] See Kuehne *v.* Union Trust Co., 133 Mich. 602, 95 N. W. 715 (1903); Larfargue *v.* Harrison, 70 Cal. 380, 11 Pac. 636 (1886); Nelson *v.* First National Bank of Chicago, 48 Ill. 36 (1868); Duncan *v.* Edgerton, 19 N. Y. Super. Ct. (6 Bosw.) 36 (1860); Baring *v.* Lyman, Fed. Cas. No. 983 (1841).

[113] See Pomeroy, Equity Jurisprudence, 4 ed., §§ 703, 704 (1918). See also 1 Williston, Contracts, §§ 432, 433 (1920).

In order to preclude the setting up of these defenses it would be necessary to go a step further and find a novation assented to in advance by the seller. Thus, where the sales contract provides that the buyer shall procure an irrevocable letter of credit, this amounts to an assent in advance by the seller to release the buyer from obligations of payment in return for the procurement of the letter of credit. The buyer procures the letter of credit, which amounts to an immediate assignment to the seller of the buyer's contract right against the bank. The transaction contains an immediate notice to the bank and a promise by the bank to pay. Defenses against the buyer-assignor which exist at the time of the novation could not be availed of against the seller-assignee by the obligor-bank even though the obligor-bank were ignorant of them at the time of the novation. If there is a novation the seller would have no right against the buyer, and the buyer would have no right against the bank. There is some indication that the courts might take this further step.[114]

7. Does the Letter of Credit Amount to a Representation that the Issuing and Drawee Banks have Received Money or its Equivalent to the Use of the Seller which the Banks are Estopped to Deny after the Seller has Acted in Reliance thereon?

It is necessary to examine one other theory that has been advanced to explain the letter of credit transaction before our analysis of the first aspect, the rights of the seller, the accredited party, against the issuing and drawee banks, is complete. It has been argued [115] that the confirmed and irrevocable letters of credit amount to a representation that the issuing or drawee bank has received funds from the buyer to the use of the seller which the bank is estopped to deny after the seller has acted in reliance on the representation. It is the usual thing, it is argued, for the buyer to deposit money with the issuing bank to be paid to the seller on the performance of certain conditions; if the buyer does not deposit actual money he arranges for a present loan, which amounts to the same thing, — this is the only meaning which *confirmed* and

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[114] See *In re* Agra and Masterman's Bank, *Ex parte* Asiatic Banking Corporation, L. R. 2 Ch. App. 391 (1867); Hindley & Co. *v.* Tothill, Watson & Co., 13 N. Z. L. R. 13 (C. A. 1894) (*semble*). *Contra*, Bell *v.* Moss, 5 Whart. (Pa.) 189 (1839).

[115] See Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1 (1918).

irrevocable can have; this is what the term *opening of credit*[116] means, — if the bank issues an irrevocable or a confirmed letter of credit without these preliminaries having been done it is estopped to deny the receipt of the money after the seller has acted on the representation. It is said that this theory will reconcile all the cases. It may reconcile all the cases, in the sense that estoppel can be used to explain anything, but it is submitted that this argument has no support either in fact or in judicial decision.

It has no support in fact. If the buyer actually deposits money with a bank for the use of the seller, or arranges for a present loan to the seller, different problems are raised.[117] But the buyer does neither of these things. It practically never happens that the purchase money under the sales contract is actually paid for the letter of credit,[118] although it is not unusual for the commission to be paid in advance. It is still rarer for the buyer to arrange a present loan in favor of the seller. Such would be contrary to the very purpose of the letter of credit. The purpose is to have a bank accept a time draft, to have that draft negotiated on the exchanges upon the credit of the bank, to enable the seller thus to get cash at once, to enable the buyer to receive the goods and market them before being obliged to pay for them in actual money. As one writer has put it, the issuing bank is lending not its funds but its credit.[119] In the last analysis, the bank which is actually supplying the money, or making the loan, is the bank which purchases the seller's drafts. Any other procedure would destroy the usefulness of the commercial letter of credit. Hence, since the buyer practically never deposits the purchase money with the issuing bank, and practically never arranges for a present loan in favor of the seller, and since the letter of credit method is well understood in the business world, how can the issue of such a letter amount to

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[116] But see UNITED STATES DEPARTMENT OF COMMERCE, PAPER WORK IN EXPORT TRADE, p. 131 (1920). "A credit is the contract of a banker to place a specified sum at the disposal of a client, subject to certain requirements stated therein. When the contract is made, the banker is said to have opened a credit for account of his client."

[117] See Harlan F. Stone, "Some Legal Problems Involved in the Transmission of Funds," 21 COL. L. REV. 507 (1921).

[118] For two cases where cash was paid in advance for the letter of credit, see British Linen Co. *v.* Caledonian Ins. Co., 4 Macq. 107 (1861); Orr & Barber *v.* Union Bank of Scotland, 1 Macq. 513 (1854).

[119] See SILVER, p. 190.

a representation that the issuing bank has received money to the use of the seller? There is more basis for the argument of estoppel in the case of the cash credit than in the case of the acceptance credit. But as between buyer, bank, and seller the principle of the two credits is the same. In reference to the acceptance credit, there is also more basis for such an argument, simply on the words of the letter, in the case of the advice of credit opened confirmed than in the case of the irrevocable letters. But both letters mean practically the same thing. The meaning of *irrevocable* and *confirmed* is plain. The bank which issues an irrevocable letter of credit says in effect that a binding contract has been made in favor of the seller and that the bank promises to pay on certain conditions. The bank which issues an advice of credit opened confirmed says in effect that it confirms the issue of the indirect irrevocable letter of credit, and either admits the authority of the bank which issued that letter to bind it, or admits that a binding contract has been made in favor of the seller and that the bank promises to pay on certain conditions. The undertaking of the bank is promissory. The only fact which it represents is that the buyer or the correspondent bank has requested the letter of credit in the form to make a binding contract and not a revocable offer.

Courts have recognized that this is the essence of the transaction. There is nothing of a trust or an equitable assignment.[120] The relation is that of debtor-creditor. The mere statements in the letter of credit are not sufficient to raise an estoppel. Estoppel must depend upon the facts of the particular case.[121]

The House of Lords has dealt decisively with this argument of estoppel. In *Morgan* v. *Larivière*[122] the French government, as buyer, entered into a sales contract with the plaintiff, as seller, for cartridges. The seller asked for a deposit of the purchase price in a London bank. No money was deposited. But the defendant bank wrote to the plaintiff a letter of credit containing the following language: ". . . We are instructed by Mr. L. *Joulin* [the French ambassador] to advise you that a special credit for

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[120] See Carpenter *v.* Sparta Savings Bank, 182 N. Y. Supp. 172 (1920); Taussig *v.* Carnegie Trust Co., 156 App. Div. 519, 141 N. Y. Supp. 347 (1913); Kuehne *v.* Union Trust Co., 133 Mich. 602, 95 N. W. 715 (1903); Roman *v.* Serna, 40 Tex. 306 (1874).

[121] See Low *v.* Bouverie, [1891] 3 Ch. 82.

[122] L. R. 7 H. L. 423 (1875).

the sum of £40,000 has been opened with us in your favour, and that it will be paid to you ratably as the goods are delivered, upon receipt of certificates of reception issued by the French ambassador. . ." The French ambassador, claiming that a condition of the sales contract had not been performed, directed the cancellation of the credit. The seller filed a bill in equity for a declaration of trust. The Court of Chancery held that the letter of credit created an equitable assignment to the plaintiff of £40,000 of the funds of the French government then in the hands of the defendant, and ordered this money to be paid into court for the satisfaction of the plaintiff's claims to the extent to which they should be proved. Upon appeal the House of Lords reversed this order. The plaintiff's counsel argued for an estoppel, saying:[123]

"The declaration that they had opened a credit in favour of the Respondent was a declaration that they had control over a fund of a certain specific amount appropriated to a certain specified purpose. Surely that is the declaration of a trust as to that specified fund, and shews that the fund itself was impressed with a trust. The Appellants could not afterwards deny what they had thus written. . . ."

Lord Cairns answered this argument:[124]

"What is there in this letter which constitutes an equitable assignment, or what is there in it which impresses with a trust any particular sum of money? I can find no expression in this letter which could authorize such a conclusion. It appears to me to be simply a statement by a banker that he has opened a credit under instructions in favour of a particular person. That is an expression well known to bankers, and well known to all persons engaged in commerce. . . . I read this letter as being nothing more than this: a statement by bankers to a tradesman who supplies goods to a customer of the bankers that they, the bankers, on behalf of their customers, will act as paymasters to the tradesman up to a certain amount of money; but that, in order to call upon them to act as paymasters, he, the tradesman, must bring with him certain certificates shewing that the goods have been delivered to their customer. In a transaction of that kind there is nothing of an equitable assignment, there is nothing of trust; and it appears to me that any banker who had given an undertaking of that kind would be very much surprised to find that it was held that a certain portion of

123 L. R. 7 H. L. 423, 428 (1875).

124 L. R. 7 H. L. 423, 432 (1875).

the funds of his customer in his hands had been impressed with a trust, had been equitably assigned, and had, in fact, ceased to be the moneys of the customer, and had become the moneys of the tradesman who was to supply the goods . . . that is the whole of this case."

In *Morgan* v. *Larivière*[125] the advice of credit opened was in the normal form. Moreover, the credit was a cash credit. Language which could not reasonably be understood to create an equitable assignment of funds actually in existence would be insufficient to estop the writer when he held in his possession no funds of the buyer.

There is only one American case which employs the doctrine of estoppel in working out the rights of the seller under an irrevocable letter of credit. The case is very illuminating when it is analyzed.

In *Johannessen* v. *Munroe*,[126] one Boe was indebted to Johannessen for a claim arising out of the breach of a charter party. Boe procured from the defendant bank the following letter of credit:

"No. 5687 Office of John Munroe & Co., Bankers
No. 32 Nassau Street,
New York, *February* 26, 1892.

"Messrs. Munroe & Co., Paris.

"*Gentlemen:* We hereby open a credit with you in favor of Captain J. A. Johannessen, S/S Raylton Dixon, for fcs. 15,000, available in bills at 90 days date; on acceptance of any bill or bills drawn under this credit you are to draw on Carsten Boe, New York, at seventy-five days date; payable at the current rate of exchange for first-class bankers' bills on Paris on day of maturity. Commission is arranged.

"Bills under this credit to be drawn at any time prior to May 1, 1892.

Truly yours,
John Munroe & Co.

"The bill may be availed of in sterling, if desired; say £600 sterling.
J. M. & Co."

Boe offered this letter to Johannessen together with $500 in full settlement of the claim. Before accepting it Johannessen

[125] L. R. 7 H. L. 423 (1875).

[126] 84 Hun, 594, 32 N. Y. Supp. 863 (1895); 9 App. Div. 409, 41 N. Y. Supp. 586 (1896); 158 N. Y. 641, 53 N. E. 535 (1899).

inquired of the issuing bank concerning the transaction. He was informed that the letter had been issued for a valuable consideration and was good and genuine. Johannessen thereupon took the letter and the $500 in absolute satisfaction of the debt. Shortly afterwards the issuing bank cancelled the letter of credit. The drawee bank accordingly refused to honor Johannessen's draft. Johannessen brought an action against the issuing bank. The complaint did not allege that the letter of credit was issued for a consideration. The trial court, on motion of the issuing bank, dismissed the action. The question before the Appellate Division was whether the facts stated in the complaint constituted a cause of action without the specific allegation of consideration. The court held that the letter of credit was a simple contract, and that therefore it was necessary to allege consideration, unless the plaintiff relied on estoppel to prevent the defendant from saying that he received no consideration. The court granted a new trial, saying: [127]

> "Where it appears that the person sought to be charged, for a valuable consideration, issued a letter of credit, and that upon the faith of it the plaintiff gave value for the benefits thereunder, a cause of action is stated, and, we think, in addition, that if the plaintiff, relying upon the faith of representations or statements of defendants that the letter was issued for a valuable consideration, parted with value, then a cause of action is stated. A right to recover in such case is based on an estoppel."

One justice dissented on the ground that the issuing bank made no representation that it had received consideration from Boe.

On the second trial the plaintiff amended his complaint and obtained a judgment. The defendant bank appealed. The Appellate Division affirmed the judgment in an opinion which was practically a quotation from the first opinion.[128] The issuing bank thereupon took the case to the Court of Appeals. In affirming the judgment that court said: [129]

> "The plaintiff suing here is not a stranger to this transaction, but is the party in whose favor the letter of credit was drawn. . . . We are

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[127] 84 Hun, 594, 598, 599, 32 N. Y. Supp. 863 (1895).

[128] Johannessen *v.* Munroe, 9 App. Div. 409, 41 N. Y. Supp. 586 (1896).

[129] Johannessen *v.* Munroe, 158 N. Y. 641, 646, 647, 648, 53 N. E. 535 (1899).

of opinion that this entire transaction, beginning with the issuing of the letter of credit and closing with the settlement referred to, presents all the elements of an estoppel, and defendants are precluded from setting up a defense based upon the alleged invalidity of the letter of credit for any cause. . . . The peculiar facts of this case control the disposition to be made of it."

Therefore, from an examination of this case it appears: (1) that there was probably a novation; (2) that the representation which gave rise to the estoppel was a representation *dehors* the letter of credit; (3) that the representation was a representation that the buyer had furnished consideration to the bank for the letter of credit, and not a representation that the bank had received money to the use of the seller; (4) that the legal question was whether there was sufficient allegation and proof that the buyer furnished consideration for the letter of credit, which bases the solution upon the theory which most American courts advocate.

In concluding a discussion of the first aspect of letters of credit, the rights of the seller, or accredited party, against the issuing and drawee banks, one thing must be emphasized: there are many types of letters of credit, and no one legal analysis will fit them all. Some letters of credit are offers; others are binding contracts from the moment of issue for which the seller furnishes the consideration as promisee; others may be contracts between the bank and the buyer for the benefit of the seller; others are contracts between the bank and the seller for which the buyer furnishes the consideration; others still may be contracts between the bank and the buyer with an assignment to the seller; there may be a novation; in exceptional cases the transaction may give rise to an estoppel. The facts of the particular transaction are controlling. But it is submitted that the usual situation, in the case of the irrevocable and confirmed letters of credit, is that the buyer furnishes the consideration for the issuing bank's promise made directly to the seller, and in those cases where agency does not exist, the issuing bank furnishes consideration for the drawee bank's promise made directly to the seller, and that this analysis, namely, that the letter of credit is a contract between the bank as promisor and the seller as promisee with the consideration moving to the promisor from one other than the promisee, is the most satis-

factory analysis in that it conforms to what the parties have in mind.

Summary of the Rights of the Seller against the Issuing and Drawee Banks

The rights of the seller against the issuing and drawee banks may be summarized as follows:

I. The authority to draw and the authority to purchase and the letter of advice are offers for unilateral contracts. As such they may be revoked at any time prior to presentation of the drafts for the first contemplated negotiation.

II. The revocable forms of the direct and indirect import letters of credit and the direct export letter of credit, and the advice of credit opened unconfirmed are offers to the seller for unilateral contracts.

III. The seller's export letter of credit is a bilateral contract between the issuing bank and the seller with consideration moving from the seller as promisee.

IV. The irrevocable forms of the direct and indirect import letters of credit, if the promise of the issuing bank does not run to the seller, may constitute contracts between the issuing bank and the buyer for the benefit of the seller.

V. Where, however, the promise runs to the seller, there is some authority that the letter constitutes an offer to the seller, and consequently is subject to revocation or modification as long as it remains an offer.

VI. There is some indication that in England the irrevocable forms of the letter of credit would be regarded as constituting contracts with the buyer which are assigned immediately to the seller.

VII. There is some American authority to the effect that the letter of credit amounts to a representation and that consequently the seller acquires a legal right against the issuing bank as soon as he acts in reliance thereon. This, however, rests upon the authority of one case only, which can be explained on its own facts, and the general proposition is unsound.

VIII. By the better and more recent view — and the trend of American decision is in this direction — the irrevocable forms

of the letter of credit are contracts between the seller as promisee and the bank as promisor with the consideration moving to the promisor from one other than the promisee. These letters of credit confer upon the seller legal rights against the bank from the moment of issue. Thus:

(1) The seller has an immediate contract right, subject to conditions, against a bank which issues a direct or an indirect import letter of credit in the irrevocable form.

(2) The seller, under an indirect letter of credit in the irrevocable form, has an immediate contract right, subject to conditions, against the drawee bank, provided the issuing bank is agent for the drawee bank.

(3) But in the absence of agency the seller acquires no contract right against the drawee bank unless and until it issues its own direct irrevocable export letter of credit, or its advice of credit opened confirmed.

In a future article an examination will be made of:

III. Rights of the purchasing bank against the issuing and drawee banks.

1. Rights under the letter of credit as a contract.
2. Rights on the bill of exchange: (a) Against the issuing and drawee banks as acceptor.
3. Rights on the bill of exchange: (b) Against the issuing and drawee banks as drawer.
4. Effect of revocation of the letter of credit.

IV. Rights of the issuing and drawee banks.

1. Relation of the sales contract to the letter of credit.
2. Conditions.
3. Conduct of the buyer.
4. Conduct of the seller.
5. Right to the goods.

V. The suretyship element in the letter of credit transaction.

VI. Assignability of the letter of credit.

William E. McCurdy.

HARVARD LAW SCHOOL.

(To be concluded.)